THE NATIONAL ARCHIVES
LITTERA SCRIPTA MANET
1934
OF THE UNITED STATES

FEDERAL REGISTER

VOLUME 8 NUMBER 219

Washington, Thursday, November 4, 1943

Regulations

TITLE 6—AGRICULTURAL CREDIT

Chapter II—War Food Administration (Commodity Credit)

[1943 C.C.C. Bran and Pea Form 1, Supp. 2]

PART 237—1943 BEAN AND PEA LOANS AND PURCHASES

INSTRUCTIONS CONCERNING BEAN PURCHASES BY COUNTY A.A.A. COMMITTEES

Pursuant to the provisions of Title III, section 302 of the Agricultural Adjustment Act of 1938, as amended (52 Stat. 43; 7 U.S.C., 1940 ed., 1302), Commodity Credit Corporation has authorized the making of loans on dry edible beans and dry edible smooth peas stored on farms in approved storage structures or in approved warehouses, in accordance with the regulations in this part (1943 C.C.C. Bean and Pea Form 1—Instructions). Such regulations are hereby supplemented by the addition, under "C. Purchases", of § 237.38 entitled "Bean purchases by County A.A.A. Committees", reading as follows:

§ 237.38 *Bean purchases by County A.A.A. Committees*—(1) *Eligible beans.* Eligible beans shall be beans produced in 1943, of the classes specified herein, which grade No. 1 and No. 2 or which can be cleaned or cleaned and picked to grade No. 2 or better.

(2) *Eligible producers.* An eligible producer shall be any person, partnership, association or corporation producing dry edible beans in 1943 as landowner, landlord, or tenant.

(3) *Program outline.* In order to handle this year's record crop of beans in an orderly and efficient manner, and assure producers of the announced support prices, it is necessary that we have close cooperation between country shippers, the county A.A.A. committee, the Food Distribution Administration, and Commodity Credit Corporation. County committees should contact country dealers to determine if they will cooperate with the 1943 Bean Program by signing a 1943 C.C.C. Edible Bean Form A, and shall also determine the quantity of beans the country shippers and country buyers in their counties can handle. Every effort should be made by county committees to have all beans purchased by country shippers. If beans are offered for sale to a country shipper, or country buyer, by a producer at the support price, less applicable charges, and the shipper or buyer does not purchase them, or if there are no country shippers or country buyers to purchase beans, arrangements should be made by county committees to purchase beans up to the capacity of C.C.C. bins or available warehouse storage, or for immediate shipment, as directed by Commodity Credit Corporation.

(4) *Purchases of beans.* County A.A.A. committees shall receive beans from the producer and draw a representative sample in cooperation with the producer. Such sample shall be mailed to the State A.A.A. laboratory or to a laboratory licensed to grade beans. The beans shall be stored in C.C.C. bins or shipped in accordance with shipping instructions from C.C.C. Payment for the beans shall be made by means of a sight draft drawn on C.C.C. in the manner designated by the producer, for the amount determined by the quantity, class, and grade of beans delivered, less applicable charges for cleaning, bags, bagging, labeling, and other charges, as stated in 1943 C.C.C. Bean Form A. The draft shall be issued by the county committees upon receipt of the analysis of the producer's beans, and the information on the scale tickets and inspection certificates is to be transferred to the sight draft. The draft is to be prepared in triplicate, the original to be issued to the producer, the first copy to be sent to the regional director of Commodity Credit Corporation on the date of preparation, and the second copy to be retained in the county office. In the event the county committee purchases a carload of beans for immediate shipment, the copies of the sight draft sent to the regional director of Commodity Credit Corporation shall be accompanied by the original bills of lading. The sight draft may be presented by the producer to a local bank or mailed to the regional office of Commodity Credit Corporation for collection. County A.A.A. committees shall send weekly reports, on Commodity Loan 23–A, of all beans purchased and placed in C.C.C. bins, to the

(Continued on next page)

CONTENTS

REGULATIONS AND NOTICES

(Continued on next page)

FEDERAL REGISTER

Published daily, except Sundays, Mondays, and days following legal holidays, by the Division of the Federal Register, The National Archives, pursuant to the authority contained in the Federal Register Act, approved July 26, 1935 (49 Stat. 500, as amended; 44 U.S.C., ch. 8B), under regulations prescribed by the Administrative Committee, approved by the President. Distribution is made only by the Superintendent of Documents, Government Printing Office, Washington, D. C.

The regulatory material appearing herein is keyed to the Code of Federal Regulations, which is published, under 50 titles, pursuant to section 11 of the Federal Register Act, as amended June 19, 1937.

The FEDERAL REGISTER will be furnished by mail to subscribers, free of postage, for $1.50 per month or $15.00 per year, payable in advance. The charge for individual copies (minimum 15¢) varies in proportion to the size of the issue. Remit check or money order, made payable to the Superintendent of Documents, directly to the Government Printing Office, Washington, D. C.

There are no restrictions on the republication of material appearing in the FEDERAL REGISTER.

CONTENTS—Continued

CONTENTS—Continued

regional director of Commodity Credit Corporation. Each producer shall sign a statement, to be retained in the county office, that all beans offered for sale were produced in 1943. All expenses incurred by the county committee in connection with the purchase program shall be claimed on the monthly expense account as reimbursable items.

(5) *Purchase price for beans.* The price paid the producer by county committees for U. S. No. 1 beans shall be the following price, according to the class and grade of beans delivered, less the applicable charges as allowed in 1943 C.C.C. Bean Form A:

(a) $6.50 per 100 lbs. net weight carlots, f. o. b. carrier, cleaned, bagged, and with all charges paid, for the following classes: Pea, Great Northern, Small White, Flat Small White, Pinto, Pink, Small Red, and Cranberry.

$7.50 per 100 lbs. net weight carlots, f.o.b. carrier, cleaned, bagged, and with all charges paid for the following classes: Lima, Baby Lima, Light Red Kidney, Dark Red Kidney, and Western Red Kidney.

(b) The purchase price for U. S. No. 2 beans shall be on the same basis, 15 cents per hundred pounds net weight less than the above purchase price for U. S. No. 1 beans.

Dated: September 18, 1943.

J. B. HUTSON,
President.

[F. R. Doc. 43-17721; Filed November 2, 1943; 4:21 p. m.]

[1943 C.C.C. Bean and Pea Form 1, Supp. 4]

PART 237—1943 BEAN AND PEA LOANS AND PURCHASES

INSTRUCTIONS CONCERNING BEAN AND PEA LOANS

Pursuant to the provisions of Title III, section 302 of the Agricultural Adjustment Act of 1938, as amended (52 Stat. 43; 7 U.S.C., 1940 ed., 1302), Commodity Credit Corporation has authorized the making of loans on dry edible beans and dry edible smooth peas stored on farms in approved storage structures or in approved warehouses, in accordance with the regulations in this part (1943 C.C.C. Bean and Pea Form 1—Instructions). Such regulations are amended as follows:

Section 237.21 *Determination of quantity of beans,* and § 237.22 *Loan rates at the farm,* under "A. Bean loans", are hereby amended to read as follows:

§ 237.21 *Determination of quantity of beans.* Loans shall be made in values expressed in cents per hundred pounds. The quantity of bulk beans stored in bins on farms shall be determined by dividing the number of cubic feet in the bin by 2.1 and multiplying the result by the percentage of sound whole beans, as shown on the analysis of the sample.

In the event beans are stored in sacks on the farm, they shall be sampled and weighed. The estimated tare weight of the sacks shall be subtracted from the total weight and the result shall be multiplied by the percentage of sound whole beans shown on the analysis of the sample.

§ 237.22 *Loan rates at the farm.*

	Per 100 lb.
U. S. No. 1	$5.50
U. S. No. 2	5.35
U. S. No. 3	5.10
U. S. Substandard:	
Damaged beans and contrasting classes totaling 7%	4.975
Damaged beans and contrasting classes totaling 8%	4.85
Damaged beans and contrasting classes totaling 9%	4.725
Damaged beans and contrasting classes totaling 10%	4.60

To determine total loan value, multiply the quantity of sound whole beans determined in accordance with § 237.22 by the applicable loan rate specified in this section.

Dated: September 16, 1943.

J. B. HUTSON,
President.

[F. R. Doc. 43-17722; Filed, November 2, 1943; 4:21 p. m.]

[1943 C.C.C. Bean and Pea Form 1 Supp. 5]

PART 237—1943 BEAN AND PEA LOANS AND PURCHASES

ELIGIBILITY FOR LOANS OF CALIFORNIA BLACK-EYE BEANS

Pursuant to the provisions of Title III, section 302 of the Agricultural Adjustment Act of 1938, as amended (52 Stat. 43; 7 U.S.C., 1940 ed., 1302), Commodity Credit Corporation has authorized the making of loans on dry edible beans and dry edible smooth peas stored on farms in approved storage structures or in approved warehouses, in accordance with the regulations in this part (1943 C.C.C. Bean and Pea Form 1—Instructions). Such regulations are hereby amended by the addition, to § 237.19,

Eligible beans, of the following new section:

§ 237.19a *Loans on California black-eye beans.* Black-eye beans will be eligible for loans provided the beans have been cleaned and the loans are secured by an insured negotiable warehouse receipt issued by a warehouse licensed under the laws of California. Evidence must be furnished that storage charges have been paid through April 30, 1944, and that loading-out charges have been prepaid. Loans shall be made at the following rates:

	Per hundredweight
U. S. No. 1 California black-eye beans	$5.50
U. S. No. 2 California black-eye beans	5.35

If the warehouse receipt is not marked "insured", an insurance certificate must be furnished carrying an endorsement to Commodity Credit Corporation indicating that the beans have been insured for full market value through April 30, 1944.

California black-eye beans placed under loan may be redeemed by paying to Commodity Credit Corporation:

(a) For U. S. No. 1 beans, $5.07½ per hundredweight, plus interest on the principal amount of the loan at the rate of 3 percent per annum;

(b) For U. S. No. 2 beans, $4.92½ per hundredweight, plus interest on the principal amount of the loan at the rate of 3 percent per annum.

All loans on black-eye beans must be made directly with the regional office of the Commodity Credit Corporation at 304 Artisans Building, Portland 5, Oregon.

The loans may be repaid immediately by submitting with the loan documents the amount required under (a) and (b) above.

Dated: September 25, 1943.

J. B. HUTSON,
President.

[F. R. Doc. 43-17720; Filed, November 2, 1943; 4:21 p. m.]

[Dairy Feed Form 1]

PART 243—OFFER OF COMMODITY CREDIT CORPORATION TO MAKE DAIRY FEED PAYMENTS

In an effort to maintain and increase the production of eligible dairy products, the War Food Administration through Commodity Credit Corporation (herein called "Commodity"), a corporate agency of the United States, pursuant to announcement heretofore made, hereby offers to make dairy feed payments to eligible producers for the quarter beginning October 1, 1943 and ending December 31, 1943, and, in the case of eligible producers in certain areas of the States of California, Mississippi and Tennessee specified herein, also for the month of September 1943, all in the manner and subject to the terms and conditions specified in this offer, such payments being intended to offset increases, since September 1942, in the cost of dairy feeds.

Sec.

AUTHORITY: §§ 243.1 to 243.11, inclusive, issued under sec. 7, 49 Stat. 4, as amended by 50 Stat. 5, 53 Stat. 510, 55 Stat. 498, and Pub. Law 151, 78th Cong.

§ 243.1 *Eligible producers.* Payments under this offer shall be available upon compliance with the terms and conditions specified herein, to the following (herein called "eligible producers"): (a) dairy farmers who sell eligible dairy products during the term of this offer; and (b) distributors and processors of eligible dairy products in respect of eligible dairy products produced from their own herds during the term of this offer.

§ 243.2 *Eligible dairy products.* The term "eligible dairy products", as used herein, shall mean whole milk, butterfat, butter, and cream produced by the eligible producer who applies for payment hereunder in respect thereof, but shall not include goat's milk or goat's milk products.

§ 243.3 *Rates of payment.* The rate of the payment hereunder shall be that specified in Schedule A, attached hereto and by this reference made a part hereof, as applicable to the period covered by such payment for the area in which the farm on which such eligible dairy products were produced is located. The areas and rates specified in such Schedule A have been determined primarily on the basis of changes in the price of dairy feed since September 1942, adjusted for (a) relative increases in the price of milk since 1938–40; and (b) average proportion of dairy feed purchased.

§ 243.4 *Measure of payment.* Payments in respect of eligible dairy products, pursuant hereto, shall be based upon the quantity of whole milk or butterfat: (a) produced by eligible producers and sold by them; or (b) in the case of eligible producers who are distributors or processors handling also dairy products produced by others, produced from their own herds, during the period covered by the application for payment. For the purpose of any such payment for the period covered by the application for payment: (1) the quantity of whole milk shall be rounded to the nearest hundredweight; (2) the quantity of butter shall be converted to pounds of butterfat on the basis of eight-tenths (.8) pound of butterfat per pound of butter; (3) the quantity of cream sold (or in the case of eligible producers who are processors or distributors, earmarked) for consumption as cream shall be converted to pounds of butterfat on the basis of four-tenths (.4) pound of butterfat per quart of cream; (4) the quantity of butterfat shall be rounded to the nearest pound; and (5) the quantity of milk sold by liquid measure shall be converted to pounds of whole milk on the basis of 2.15 pounds per quart. To the extent that eligible producers deliver whole milk and do not recover their skim milk, payments hereunder shall be made on the basis of the applicable whole milk rates regardless of the basis on which they are paid for their product. To the extent that eligible producers deliver cream or butter, or deliver milk as whole milk and recover their skim milk, payments hereunder shall be made at the applicable butterfat rate. Payments made to eligible producers covering operations during the month of September 1943, shall be made only in respect of whole milk without recovery of skim milk.

§ 243.5 *Prerequisites to payment.* Payments hereunder will be made only to eligible producers who: (a) file applications for payment, in such form as shall be approved by Commodity, with the County AAA Committee in the county in which the eligible dairy products covered thereby were produced not later than November 30, 1943, with respect to September and October operations, and not later than January 31, 1944, with respect to November and December operations, and (b) supply, with such applications for payment, evidence satisfactory to such County AAA Committee with respect to their eligibility, compliance with this offer, and the proper amounts of such payments. Milk statements or sale receipts issued by cooperatives, dairies, creameries, and others, showing the amount of whole milk or butterfat purchased, the date of purchase, and the names of the seller and buyer will be considered satisfactory evidence of sales. If an eligible producer is unable to furnish satisfactory extrinsic written evidence of sale, his personal certification of the amount sold, number of cows milked, amount and type of feed used, and customers served, may, in the discretion of the County AAA Committee, and subject to such rules as Commodity prescribes, be accepted as sufficient if such certification is consistent with the County AAA Committee's knowledge of the eligible producer's business and is made in accordance with rules as prescribed by Commodity. In the event an eligible producer is also a distributor only of eligible dairy products produced by him, sales of eligible dairy products in the course of such distribution may be totaled for the purpose of recording on the application for payment.

§ 243.6 *Payment.* Payment hereunder, on the basis of each such application for payment which has been approved by the applicable County AAA Committee, shall, unless Commodity prescribes a different method of payment, be made by such County AAA Committee by a non-interest-bearing draft drawn on Commodity and payable at any Federal Reserve Bank or branch thereof. If the amount of payment to which the eligible producer would otherwise be entitled, as computed by the County AAA Committee, is less than one dollar

($1.00), no payment shall be made. Payments applicable to an eligible producer's operations hereunder for October (and for September, if covered by this offer) shall be made as soon as practicable after October 31, 1943, and payments applicable to an eligible producer's operations hereunder for November and December shall be made as soon as practicable after December 31, 1943. Such draft shall be made payable to the person shown in the corresponding application for payment to be the eligible producer, except in the case of death, incompetency, or disapparance of such person. Each draft shall be given a serial number and shall be prepared in duplicate. The original thereof shall be delivered to the eligible producer and the copy retained in the County AAA office. The making of any payment on the basis of an approved application for payment filed hereunder shall not constitute final acceptance of the validity or amount of the claim represented thereby. In the event of a subsequent finding that any such claim is invalid, defective or incorrectly computed, Commodity shall have the right to require restitution of any such payment or any part thereof, such right being in addition to any and all other rights of Commodity in the premises.

§ 243.7 *Assignment and set-off.* Payments due or to become due hereunder shall not be assignable in whole or in part. Payments hereunder shall be subject to set-offs for indebtedness of the eligible producer to United States of America or any agency or corporation thereof recorded on any County AAA office debt register and this offer is expressly made subject to such provision for set-offs.

§ 243.8 *Death, incompetency, or disappearance.* In case of death, incompetency, or disappearance of an eligible producer, application for any payment hereunder may be made by any person who, under the regulations contained in Agricultural Adjustment Administration Form ACP–122, would be entitled to payment. In any such case, the person filing the application shall execute Agricultural Adjustment Administration Form ACP–103 and file such executed form, attached to the application for payment hereunder, with the County AAA Committee.

§ 243.9 *Lost, stolen, or destroyed drafts.* In the event any executed draft shall be lost, stolen, or destroyed, the fact of such loss, theft, or destruction shall be reported immediately to the office of the applicable County AAA Committee and, in such event, the issuance of a duplicate draft shall be subject to such conditions as Commodity shall, from time to time, prescribe.

§ 243.10 *Right to declare applications for payment invalid.* Commodity, acting through the applicable County AAA Committee, or otherwise, shall have the right to declare invalid, in whole or in part, any application for payment hereunder in the event the applicant does not qualify as an eligible producer hereunder, or such application for payment is not in conformity with this offer.

§ 243.11 *Instructions and interpretations.* Commodity shall have the right to supplement or clarify any provision or provisions of this offer, or alter any procedure contained herein, at any time by the issuance of instructions or interpretations in connection therewith.

Dated: October 16, 1943.

COMMODITY CREDIT CORPORATION,

[SEAL] By J. B. HUTSON, *President.*

Attest:

NORINE J. FAUBLE,
Assistant Secretary.

SCHEDULE A

Rates of payment in the various States and counties to which this offer is applicable during the period September 1–30, 1943:

States	Counties	Rate per cwt. of whole milk
		Cents
California	Ventura	25
	Imperial	25
	Los Angeles	25
	Santa Barbara	25
	San Bernardino	25
	Orange	25
	Riverside	25
	San Diego	25
Mississippi	De Soto	25
	Marshall	25
	Panola	25
	Tate	25
Tennessee	Fayette	25
	Shelby	25

Rates of payment in the various States and counties covering the period October 1–December 31, 1943:

States	Counties	Rate per cwt. of whole milk delivered	Rate per lb. of butterfat
		Cents	*Cents*
Alabama	All counties	40	5
Arizona	do	40	5
Arkansas	do	50	6
California	Imperial	50	6
	Los Angeles	50	6
	Santa Barbara	50	6
	Orange	50	6
	Riverside	50	6
	San Bernardino	50	6
	San Diego	50	6
	Ventura	50	6
	Alpine	35	4
	Amador	35	4
	Calaveras	35	4
	Eldorado	35	4
	Inyo	35	4
	Lassen	35	4
	Modoc	35	4
	Mono	35	4
	Nevada	35	4
	Placer	35	4
	Plumas	35	4
	Sierra	35	4
	Tuolumne	35	4
	All other counties	45	5
Colorado	All counties	35	4
Connecticut	do	50	6
Delaware	do	40	5
Florida	do	40	5
Georgia	do	40	5
Idaho	do	35	4
Illinois	Boone	30	4
	Bureau	30	4
	Carroll	30	4
	Cook	30	4
	De Kalb	30	4
	Du Page	30	4
	Ford	30	4
	Grundy	30	4
	Henderson	30	4
	Henry	30	4
	Iroquois	30	4
	Jo Daviess	30	4
	Kane	30	4
	Kankakee	30	4
	Kendall	30	4
	Knox	30	4
	Lake	30	4
	La Salle	30	4
	Lee	30	4
	Livingston	30	4
	McHenry	30	4
	Marshall	30	4
	Mercer	30	4
	Ogle	30	4
	Peoria	30	4
	Putnam	30	4
	Rock Island	30	4
	Stark	30	4
	Stephenson	30	4
	Warren	30	4
	Whiteside	30	4
	Will	30	4
	Winnebago	30	4
	Woodford	30	4
	All other counties	35	4
Indiana	Adams	30	4
	Allen	30	4
	Benton	30	4
	Cass	30	4
	De Kalb	30	4
	Elkhart	30	4
	Fulton	30	4
	Huntington	30	4
	Jasper	30	4
	Kosciusko	30	4
	Lagrange	30	4
	Lake	30	4
	La Porte	30	4
	Marshall	30	4
	Miami	30	4
	Newton	30	4
	Noble	30	4
	Porter	30	4
	Pulaski	30	4
	St. Joseph	30	4
	Starke	30	4
	Steuben	30	4
	Wabash	30	4
	Wells	30	4
	White	30	4
	Whitley	30	4
	All other counties	35	4
Iowa	All counties	30	4
Kansas	Barber	50	6
	Cherokee	50	6
	Clark	50	6
	Comanche	50	6
	Ford	50	6
	Harper	50	6
	Kiowa	50	6
	All other counties	35	4
Kentucky	All counties	35	4
Louisiana	Bienville	50	6
	Bossier	50	6
	Caddo	50	6
	Caldwell	50	6
	Catahoula	50	6
	Claiborne	50	6
	Concordia	50	6
	De Soto	50	6
	East Carroll	50	6
	Franklin	50	6
	Grant	50	6
	Jackson	50	6
	La Salle	50	6
	Lincoln	50	6
	Madison	50	6
	Morehouse	50	6
	Natchitoches	50	6
	Ouachita	50	6
	Red River	50	6
	Richland	50	6
	Sabine	50	6
	Tensas	50	6
	Union	50	6
	Webster	50	6
	West Carroll	50	6
	Winn	50	6
	All other counties	40	5
Maine	All counties	40	5
Maryland	do	40	5
Massachusetts	do	50	6
Michigan	do	30	4
Minnesota	do	30	4
Mississippi	Clarke	40	5
	Forrest	40	5
	George	40	5
	Greene	40	5
	Hancock	40	5
	Harrison	40	5
	Jackson	40	5
	Jasper	40	5
	Jones	40	5

States	Counties	Rate per cwt. of whole milk delivered	Rate per lb. of butterfat
		Cents	*Cents*
Mississippi	Kemper	40	5
	Lauderdale	40	5
	Lowndes	40	5
	Newton	40	5
	Noxubee	40	5
	Pearl River	40	5
	Perry	40	5
	Smith	40	5
	Stone	40	5
	Wayne	40	5
	All other counties	50	6
Missouri	Barry	50	6
	Jasper	50	6
	McDonald	50	6
	Newton	50	6
	Stone	50	6
	All other counties	35	4
Montana	All counties	35	4
Nebraska	do	30	4
Nevada	do	35	4
N. Hampshire	do	40	5
N. Jersey	do	50	6
New Mexico	do	40	5
New York	do	40	5
North Carolina	do	40	5
North Dakota	do	30	4
Ohio	Allen	30	4
	Crawford	30	4
	Defiance	30	4
	Fulton	30	4
	Hancock	30	4
	Henry	30	4
	Lucas	30	4
	Ottawa	30	4
	Paulding	30	4
	Putnam	30	4
	Sandusky	30	4
	Seneca	30	4
	Van Wert	30	4
	Williams	30	4
	Wood	30	4
	Wyandot	30	4
	All other counties	35	4
Oklahoma	Beaver	40	5
	Cimarron	40	5
	Texas	40	5
	All other counties	50	6
Oregon	Benton	45	5
	Clackamas	45	5
	Clatsop	45	5
	Columbia	45	5
	Coos	45	5
	Curry	45	5
	Douglas	45	5
	Hood River	45	5
	Jackson	45	5
	Josephine	45	5
	Lane	45	5
	Lincoln	45	5
	Linn	45	5
	Marion	45	5
	Multnomah	45	5
	Polk	45	5
	Tillamook	45	5
	Washington	45	5
	Yamhill	45	5
	All other counties	35	4
Pennsylvania	All counties	40	5
Rhode Island	do	50	6
South Carolina	do	40	5
South Dakota	do	30	4
Tennessee	Crockett	50	6
	Fayette	50	6
	Hardeman	50	6
	Haywood	50	6
	Lauderdale	50	6
	Shelby	50	6
	Tipton	50	6
	All other counties	35	4
Texas	Archer	50	6
	Baylor	50	6
	Borden	50	6
	Bosque	50	6
	Bowie	50	6
	Brown	50	6
	Callahan	50	6
	Camp	50	6
	Cass	50	6
	Childress	50	6
	Clay	50	6
	Coke	50	6
	Coleman	50	6
	Collin	50	6
	Collingsworth	50	6
	Comanche	50	6
	Concho	50	6
Texas	Cooke	50	6
	Coryell	50	6
	Dallas	50	6
	Dawson	50	6
	Delta	50	6
	Denton	50	6
	Eastland	50	6
	Ellis	50	6
	Erath	50	6
	Fannin	50	6
	Fisher	50	6
	Foard	50	6
	Franklin	50	6
	Grayson	50	6
	Gregg	50	6
	Hamilton	50	6
	Hardeman	50	6
	Harrison	50	6
	Haskell	50	6
	Henderson	50	6
	Hill	50	6
	Hood	50	6
	Hopkins	50	6
	Howard	50	6
	Hunt	50	6
	Jack	50	6
	Johnson	50	6
	Jones	50	6
	Kaufman	50	6
	Knox	50	6
	Lamar	50	6
	Lampasas	50	6
	Llano	50	6
	McCulloch	50	6
	Marion	50	6
	Martin	50	6
	Mills	50	6
	Mitchell	50	6
	Montague	50	6
	Morris	50	6
	Navarro	50	6
	Nolan	50	6
	Palo Pinto	50	6
	Parker	50	6
	Rains	50	6
	Red River	50	6
	Rockwell	50	6
	Runnels	50	6
	San Saba	50	6
	Scurry	50	6
	Shackelford	50	6
	Smith	50	6
	Sommervell	50	6
	Stephens	50	6
	Tarrant	50	6
	Taylor	50	6
	Throckmorton	50	6
	Titus	50	6
	Tom Green	50	6
	Upshur	50	6
	Van Zandt	50	6
	Wheeler	50	6
	Wichita	50	6
	Wilbarger	50	6
	Wise	50	6
	Wood	50	6
	Young	50	6
	All other counties	40	5
Utah	All counties	35	4
Vermont	do	40	5
Virginia	do	40	5
Washington	Clallam	45	5
	Clark	45	5
	Cowlitz	45	5
	Grays Harbor	45	5
	Island	45	5
	Jefferson	45	5
	King	45	5
	Kitsap	45	5
	Lewis	45	5
	Mason	45	5
	Pacific	45	5
	Pierce	45	5
	San Juan	45	5
	Skagit	45	5
	Skamania	45	5
	Snohomish	45	5
	Thurston	45	5
	Wahkiakum	45	5
	Whatcom	45	5
	All other counties	35	4
West Virginia	All counties	40	5
Wisconsin	All counties	30	4
Wyoming	All counties	35	4

[F. R. Doc. 43-17704; Filed, November 1, 1943; 5:27 p. m.]

[Dairy Feed Form 1, Amdt. 1]

PART 243—OFFER OF COMMODITY CREDIT CORPORATION TO MAKE DAIRY FEED PAYMENTS

RATES OF PAYMENTS

NOVEMBER 1, 1943.

In order to preserve, with respect to eligible producers in the various sections of the United States, substantial uniformity of treatment under the offer of Comodity Credit Corporation to make dairy feed payments (herein called the "offer"), issued October 16, 1943, in the light of the price increase accruing to such eligible producers under Order No. 27 Regulating the handling of milk in the New York Metropolitan Marketing Area, issued by the Secretary of Agriculture on March 26, 1942, as amended to the date hereof in respect of milk of which such eligible producers are "producers" as that term is defined in such Order No. 27 and the milk purchase program to be undertaken by Commodity Credit Corporation (herein called "Commodity") to make it possible for handlers to pay such price increase to such producers, Commodity hereby amends the offer in the manner and to the extent provided in this Amendment No. 1 to the offer.

Section 243.3 of the offer is hereby amended to read as follows:

§ 243.3 *Rates of payment.* The rate of the payment hereunder shall be that specified in Schedule A, attached hereto and by this reference made a part hereof, as applicable to the period covered by such payment for the area in which the farm on which such eligible dairy products were produced is located: *Provided, however,* That for the months of November and December, 1943, the applicable rate of payment hereunder to an eligible producer per hundredweight of whole milk which is not excluded from the computation of the net pool obligation pursuant to 7 CFR 927.6 (a) (2), issued by the Secretary of Agriculture on March 26, 1942, as amended to the date hereof, and in respect of which he is a "producer" as that term is defined in such Order No. 27, shall be fifteen cents (15c) less per hundredweight than the applicable rate stipulated in said Schedule A. The areas and rates specified herein and in such Schedule A have been determined primarily on the basis of changes in the price of dairy feed since September 1942, adjusted for (a) relative increases in the price of milk since 1938–40; and (b) average proportion of dairy feed purchased.

(Sec. 7, 49 Stat. 4, as amended by 50 Stat. 5, 53 Stat. 510, 55 Stat. 498, and Pub. Law 151, 78th Cong.)

COMMODITY CREDIT CORPORATION,

[SEAL] By J. B. HUTSON, *President.*

Attest:

ZELMA DAVIS,
Assistant Secretary.

[F. R. Doc. 43-17703; Filed, November 1, 1943; 5:27 p. m.]

TITLE 26—INTERNAL REVENUE

Chapter I—Bureau of Internal Revenue

Subchapter A—Income and Excess-Profits Taxes

[Regulations 111]

PART 29—INCOME TAX; YEARS BEGINNING AFTER DECEMBER 31, 1941

NOTE: The table of contents and Subparts A and B appeared in the issue of Wednesday, November 3, 1943.

SUBPART C—SUPPLEMENTAL PROVISIONS

RATES OF TAX

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS [as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

The following organizations shall be exempt from taxation under this chapter—

§ 29.101–1 *Proof of exemption.* A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption under section 101 (6), Form 1023; under section 101 (1), (3), (7), or (8), Form 1024; under section 101 (9), Form 1025; under section 101 (10), (14), or (16), Form 1026; under section 101 (4), except bona fide credit unions, Form 1027; and under section 101 (12), Form 1028. All other organizations claiming exemption, including bona fide credit unions, shall file an affidavit showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization. An organization claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation: *Provided, however,* That such return shall not be required of an organization which is organized and operated exclusively for educational purposes, or educational and religious purposes, if no part of its net earnings or assets are distributable to any private shareholder in liquidation or otherwise and if, in the case of an organization privately owned or operated, the Commissioner is advised of any increase in the compensation of its owners, managers, trustees, or directors over the amount of such compensation for the last year for which its exemption under section 101 (6) was approved by the Commissioner. Form 990 will not be required of charitable organizations operated or controlled by religious or educational organizations of the type exempt under the preceding sentence from the requirement of filing such returns, nor of separately conducted charitable organizations meeting the above conditions as to distributions and compensation, nor of charitable organizations operated under the control of a State or any political subdivision thereof.

The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation. Although religious or apostolic associations or corporations exempt under section 101 (18) are relieved from paying the tax, they are required to file returns of income (see § 29.101 (18)–1).

In the case of the particular classes of organizations listed below, the following additional information shall be embodied in or attached to, and made a part of, the affidavit or questionnaire referred to above:

(a) Mutual insurance companies shall submit copies of the policies or certificates of membership;

(b) In the case of holding companies claiming exemption under section 101 (14), if the organization for which title is held has not been specifically notified in writing by the Bureau of Internal Revenue that it is held to be exempt under section 101, the holding company shall submit the information indicated herein as necessary for a determination of the status of the organization for which title is held.

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward completed documents to the Commissioner for decision as to whether the organization is exempt. In addition to the information specified herein, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization exempt or claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization: *Provided, however,* That such return shall not be required of an organization which is organized and operated exclusively for educational purposes, or educational and religious purposes, if no part of its net earnings or assets are distributable to any private shareholder in liquidation or otherwise and if, in the case of an organization privately owned or operated, the Commissioner is advised of any increase in the compensation of its owners, managers, trustees, or directors over the amount of such compensation for the last year for which its exemption under section 101 (6) was approved by the Commissioner. Form 990 will not be required of charitable organizations operated or controlled by religious or educational organizations of the type exempt under the preceding sentence from the requirement of filing such returns, nor of separately conducted charitable organizations meeting the above conditions as to distributions and compensation, nor of charitable organizations operated under the control of a State or any political subdivision thereof. The return of information on Form 990 shall be filed on or before the 15th day of the fifth month following the close of the taxable year. When a mutual insurance company has established its right to exemption under section 101 (11) of the Internal Revenue Code or a corresponding provision of a prior income tax law it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or unless the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) exceeds $75,000. See § 29.101 (18)–1 with respect to returns by religious or apostolic associations or corporations exempt under section 101 (18). See also sections 275 (a) and 276 (a) with respect to the statute of limitations.

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally inquire into their status and ascertain whether or not

they are observing the conditions upon which their exemption is predicated.

An organization which is exempt under section 101 and the regulations thereunder, from filing returns of income is not, however, relieved from the duty of filing returns of information (see sections 147 and 148).

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act, 1939; secs. 137 (a), 165 (a), Rev. Act, 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(1) Labor, agricultural, or horticultural organizations;

§ 29.101 (1)–1 *Labor, agricultural, and horticultural organizations.* The organizations contemplated by section 101 (1) as entitled to exemption from income taxation are those which:

(a) Have no net income inuring to the benefit of any member;

(b) Are educational or instructive in character; and

(c) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

Organizations such as county fairs and like associations of a quasi public character, which are designed to encourage the development of better agricultural and horticultural products through a system of awards, and whose income from gate receipts, entry fees, and donations is used exclusively to meet the necessary expenses of upkeep and operation, are thus exempt. On the other hand, associations which have for their purpose, for example, the holding of periodical race meets, the profits from which may inure to the benefit of their shareholders, are not exempt. Similarly, corporations engaged in growing agricultural or horticultural products for profit are not exempt from tax.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act. 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(2) Mutual savings banks not having a capital stock represented by shares;

§ 29.101 (2)–1 *Mutual savings banks.* In order that a corporation may be entitled to exemption as a mutual savings bank, it must appear that it is an organization:

(a) Which has no capital stock represented by shares, and

(b) Whose earnings, less only the expenses of operation, are distributable wholly among the depositors.

If it appears that the organization has shareholders who participate in the profits, the organization will not be exempt.

A mutual savings bank need not be incorporated or be under public supervision, unless, in either case a State statute so requires, nor need it serve the public in general, in order to be exempt. It may confine its business to a designated class of individuals, such as employees of a single corporation, without losing its exempt status.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act. 1939; secs. 137 (a), 165 (a), Rev. Act. 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(3) Fraternal beneficiary societies, orders, or associations, (A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

§ 29.101 (3)–1 *Fraternal beneficiary societies.* A fraternal beneficiary society is exempt from tax only if operated under the "lodge system," or for the exclusive benefit of the members of a society so operating. "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

§ 29.101 (4)–1 *Building and loan associations and cooperative banks.* A building and loan association organized pursuant to and operating in accordance with the laws of the United States or a State or Territory thereof, substantially all the business of which association is confined to making loans to members, is entitled to exemption.

Cooperative banks without capital stock organized and operated for mutual purposes and without profit are exempt. Credit unions such as those organized under the laws of Massachusetts, being in substance and in fact the same as cooperative banks, are likewise exempt from tax.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; Secs. 137 (a), 165 (a), Rev. Act. 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(5) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

§ 29.101 (5)–1 *Cemetery companies.* A cemetery company may be entitled to exemption:

(a) If it is owned by and operated exclusively for the benefit of its lot owners who hold such lots for bona fide burial purposes and not for purpose of resale, or

(b) If it is not operated for profit.

Any cemetery corporation chartered solely for burial purposes and not permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual. A cemetery company which fulfills the other requirements of the Internal Revenue Code may be exempt, even though it issues preferred stock entitling the holders to dividends at a fixed rate, not exceeding the legal rate of interest in the State of incorporation, or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, provided that its articles of incorporation require:

(1) That the preferred stock shall be retired at par as soon as sufficient funds available therefor are realized from sales, and

(2) That all funds not required for the payment of dividends upon or for the retirement of preferred stock shall be used by the company for the care and improvement of the cemetery property.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act. 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

§ 29.101 (6)–1 *Religious, charitable, scientific, literary, and educational organizations and community chests.* In order to be exempt under section 101 (6), the organization must meet three tests:

(a) It must be organized and operated exclusively for one or more of the specified purposes;

(b) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(c) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An educational organization within the meaning of the Internal Revenue Code is one designed primarily for the improvement or development of the capabilities of the individual, but, under exceptional

circumstances, may include an association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community, even though an association of either class has incidental amusement features. An organization formed, or availed of, to disseminate controversial or partisan propaganda is not an educational organization within the meaning of the Code. However, the publication of books or the giving of lectures advocating a cause of a controversial nature shall not of itself be sufficient to deny an organization the exemption, if carrying on propaganda, or otherwise attempting, to influence legislation forms no substantial part of its activities, its principal purpose and substantially all of its activities being clearly of a nonpartisan, noncontroversial, and educational nature.

Since a corporation to be exempt under section 101 (6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufacturers and sells articles to the public for profit, is not exempt under section 101 (6) even though its property is held in common and its profits do not inure to the benefit of individual members of the organization. See section 101 (18) as to religious or apostolic associations or corporations.

A corporation otherwise exempt under section 101 (6) does not lose its status as an exempt corporation by receiving income such as rent, dividends, and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in that section.

[SEC. 101. *Exemptions from tax on corporations*—as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(7) Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private share holder or individual;

§ 29.101 (7)–1 *Business leagues, chambers of commerce, real estate boards, and boards of trade.* A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated. A stock exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of the Internal Revenue Code and is not exempt from tax.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act. 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes;

§ 29.101 (8)–1 *Civic leagues and local associations of employees.* Civic leagues entitled to exemption under section 101 (8) comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations comprehended within section 101 (6). Certain local associations of employees are also expressly entitled to exemption under section 101 (8). The Internal Revenue Code prescribes as conditions to exemption (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. See § 29.101 (6)–1 with reference to the meaning of "charitable" and "educational" and § 29.101 (10)–1 as to the meaning of "local" as used in the Code.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act, 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

§ 29.101 (9)–1 *Social clubs.* The exemption granted by section 101(9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(10) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses;

§ 29.101 (10)–1 *Local benevolent life insurance associations, mutual irrigation and telephone companies, and like organizations.* It is a prerequisite to exemption under section 101 (10) that at least 85 percent of the income of the organization shall consist of amounts collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, or if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 percent of its income is derived, it is not entitled to exemption. On the other hand, an organization may be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

The phrase "of a purely local character" applies to benevolent life insurance associations, and not to the other organizations specified in section 101 (10). It applies, however, to any organization seeking exemption on the ground that it is an organization similar to a benevolent life insurance association. An organization of a purely local character is one whose business activities are confined to a particular community, place, or district, irrespective, however, of political subdivisions. If the activities of an organization are limited only by the borders of a State, it cannot be considered to be purely local in character.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a) Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(11) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000;

§ 29.101 (11)–1 *Mutual insurance companies or associations.* An insurance company is exempt from taxation under this chapter if it is a mutual company or association (other than life or marine) or an interinsurer or reciprocal underwriter and if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000. Such a company is not required to file income-tax returns or pay income taxes.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; Secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(12) Farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less than necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption be denied any such association because their is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 per centum of the value of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph;

§ 29.101 (12)–1 *Farmers' cooperative marketing and purchasing associations.* (a) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from income tax and shall not be required to file returns. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Internal Revenue Code and is not exempt. In other words, nonmember patrons must be treated the same as members in so far as the distribution of patronage dividends is concerned, that is, if products are marketed for nonmember producers, the proceeds of the sale, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such proceeds result, whether or not such patrons are members of the association. In order to show its cooperative nature and to establish compliance with the requirement of the Code that the proceeds of sales, less necessary expenses, be turned back to all producers on the basis of the products furnished by them, it is necessary for such an association to keep permanent records of the business done both with members and nonmembers. The Code does not require, however, that the association keep ledger accounts with each producer selling through the association. Any permanent records which show that the association was operating during the taxable year on a cooperative basis in the distribution of patronage dividends to all producers will suffice. While under the Code patronage dividends must be paid to all producers on the same basis, this requirement is complied with if an association, instead of paying patronage dividends to nonmember producers in cash, keeps permanent records from which the proportionate shares of the patronage dividends due to nonmember producers can be determined, and such shares are made applicable toward the purchase price of a share of stock or of a membership in the association.

An association which has capital stock will not for such reason be denied exemption (1) if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and (2) if substantially all of such stock (with the exception noted below) is owned by producers who market their products or purchase their supplies and equipment through the association. Any ownership of stock by others than such actual producers must be satisfactorily explained in the association's application for exemption. The association will be required to show that the ownership of its capital stock has been restricted as far as possible to such actual producers. If by statutory requirement all officers of an association must be shareholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a shareholder for any reason ceases to be a producer and the association is unable, because of a constitutional restriction or prohibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that under such circumstances a small amount of the outstanding capital stock is owned by shareholders who are no longer producers will not destroy the exemption. The restriction placed on the ownership of capital stock of an exempt cooperative association shall not apply to nonvoting preferred stock, provided the owners of such stock are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends. The accumulation and maintenance of a reserve required by State statute, or the accumulation and maintenance of a reasonable reserve or surplus for any necessary purpose, such as to provide for the erection of buildings and facilities required in business or for the purchase and installment of machinery and equipment or to retire indebtedness incurred for such purposes, will not destroy the exemption. An association will not be denied exemption because it markets the products of nonmembers, provided the value of the products marketed for nonmembers does not exceed the value of the products marketed for members. Anyone who shares in the profits of a farmers' cooperative marketing association, and is entitled to participate in the management of the association, must be regarded as a member of such association within the meaning of section 101 (12).

(b) Cooperative associations engaged in the purchasing of supplies and equipment for farmers, fruit growers, livestock growers, dairymen, etc., and turning over such supplies and equipment to them at actual cost, plus the necessary operating expenses, are exempt. The term "supplies and equipment" as used in section 101 (12) includes groceries and all other goods and merchandise used by farmers in the operation and maintenance of a farm or farmer's household. The provisions of paragraph (a) of this section relating to a reserve or surplus and to capital stock shall apply to associations coming under this paragraph. An association which purchases supplies and equipment for nonmembers will not for such reason be denied exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the value of the purchases made for nonmembers who are not producers does not exceed 15 percent of the value of all its purchases.

(c) In order to be exempt under either paragraph (a) or (b) of this section an association must establish that it has no net income for its own account other than that reflected in a reserve or surplus authorized in paragraph (a). An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements of the Internal Revenue Code. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under section 101 (12) and this section. An association to be entitled to exemption must not only be organized but actually operated in the manner and for the purposes specified in section 101 (12).

(d) Cooperative organizations engaged in occupations dissimilar from those of farmers, fruit growers, and the like, such as marketing building materials, are not exempt.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(13) Corporations organized by an association exempt under the provisions of paragraph (12), or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers,

and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose;

§ 29.101 (13)–1 *Corporations organized to finance crop operations.* Corporations organized by farmers' cooperative marketing or purchasing associations, or the members thereof, for the purpose of financing the ordinary crop operations of such members or other producers are also exempt, provided the marketing or purchasing association is exempt under section 101 (12), and the financing corporation is operated in conjunction with the marketing or purchasing association. The provisions of § 29.101 (12)–1 relating to a reserve or surplus and to capital stock shall also apply to corporations coming under this section.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217 (a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter;

(15) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes;

(16) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (B) 85 per centum or more of the income consists of amounts collected from members and amounts contributed to the association by the employer of the members for the sole purpose of making such payments and meeting expenses;

(17) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts received from public taxation, amounts received from assessments upon the teaching salaries of members, and income in respect of investments;

(18) Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro-rata shares, whether distributed or not, of the net income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

§ 29.101 (18)–1 *Religious or apostolic associations or corporations.* Religious or apostolic associations or corporations are exempt from taxation under chapter 1 if they have a common treasury or community treasury, even though they engage in business for the common benefit of the members, provided each of the members include (at the time of filing his return) in his gross income his entire pro rata share, whether distributed or not, of the net income of the association or corporation for the taxable year of the association or corporation ending with or during his taxable year. Any amount so included in the gross income of a member shall be treated as a dividend received.

Every association or corporation claiming exemption as a religious or apostolic association or corporation under the provisions of section 101 (18) and this section shall make for each taxable year a return stating specifically the items of its gross income and deductions, and its net income, and there shall be attached to the return as a part thereof a statement showing the name and address of each member of the association or corporation and the amount of his distributive share of the net income of the association or corporation for such year. If the taxable year of any member is different from the taxable year of the association or corporation, the distributive share of the net income of the association or corporation to be included in the gross income of the member for his taxable year shall be based upon the net income of the association or corporation for the taxable year of the association or corporation ending within the taxable year of the member.

[SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS—as amended by sec. 217(a), Rev. Act 1939; secs. 137 (a), 165 (a), Rev. Act 1942.]

[The following organizations shall be exempt from taxation under this chapter—]

(19) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or their designated beneficiaries, if (A) admission to membership in such association is limited to individuals who are officers or employees of the United States Government, and (B) no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS [as amended by sec. 211 (f), Rev. Act 1939; secs. 103 (d), 202 (b), Rev. Act 1941; secs. 105 (e), 135 (b), 138, Rev. Act 1942.]

(a) *Imposition of tax.* There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

38½ per centum of the undistributed section 102 net income in excess of $100,000.

(b) *Prima facie evidence.* The fact that any corporation is a mere holding or investment company shall be prima facie evidence of a purpose to avoid surtax upon shareholders.

(c) *Evidence determinative of purpose.* The fact that the earnings or profits of a corporation are permited to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary.

(d) *Definitions.* As used in this chapter—

(1) *Section 102 net income.* The term "section 102 net income" means the net income, computed without the benefit of the capital loss carry-over provided in section 117 (e) from a taxable year which begins after December 31, 1940, and computed without the net operating loss deduction provided in section 23 (s), minus the sum of—

(A) *Taxes.* Federal income, war-profits, and excess-profits taxes (other than the tax imposed by subchapter E of chapter 2 for a taxable year beginning after December 31, 1940) paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

(B) *Disallowed charitable, etc., contributions.* Contributions or gifts payment of which is made within the taxable year, not otherwise allowed as a deduction, to or for the use of donees described in section 23 (o), for the purposes therein specified.

(C) *Disallowed losses.* Losses from sales or exchanges of capital assets which are disallowed as a deduction by section 117 (d).

(D) *Income subject to excess-profits tax.* The credit for income subject to the tax imposed by subchapter E of chapter 2 provided in section 26 (e).

(2) *Undistributed section 102 net income.* The term "undistributed section 102 net income" means the section 102 net income minus the basic surtax credit provided in section 27 (b), but the computation of such credit under section 27 (b) (1) shall be made without its reduction by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(e) *Tax on personal holding companies.* For surtax on personal holding companies, see section 500.

(f) *Income not placed on annual basis.* Section 47 (c) shall not apply in the computation of the tax imposed by this section.

§ 29.102–1 *Taxation of corporation formed or utilized for avoidance of surtax.* Section 102 imposes (in addition to other taxes imposed by chapter 1) a graduated income tax or surtax upon any domestic or foreign corporation formed or availed of to avoid the imposition of the individual surtax upon its shareholders or the shareholders of any other corporation through the medium of permitting earnings or profits to accumulate instead of dividing or distributing them. However, personal holding companies, as defined in section 501, and foreign personal holding companies, as defined in Supplement P (see section 331), are excepted from taxation under section 102. The surtax imposed by section 102 applies whether the avoidance was accomplished through the forma-

tion or use of only one corporation or a chain of corporations. For example, if the capital stock of the M Corporation is held by the N Corporation so that the dividend distributions of the M Corporation would not be returned as income subject to the individual surtax until distributed in turn by the N Corporation to its individual shareholders, nevertheless the surtax imposed by section 102 applies to the M Corporation, if that corporation is formed or availed of for the purpose of preventing the imposition of the individual surtax upon the individual shareholders of the N Corporation.

A foreign corporation, whether resident or nonresident, formed or availed of for the purpose specified in section 102 is subject to the tax imposed thereby if it derives income from sources within the United States as defined in section 119 and the regulations thereunder, if any of its shareholders are (1) citizens or residents of the United States and therefore subject to the surtax with respect to distributions of the corporation or (2) nonresident alien individuals who, by the application of section 211 (b) or section 211 (c), would be subject to the surtax with respect to distributions of the corporation which if made would constitute income from sources within the United States (see section 119) or (3) foreign corporations if any beneficial interest therein is owned directly or indirectly by any shareholder specified in (1) or (2). On the other hand, the tax imposed by section 102 will not apply even though a foreign corporation, whether resident or nonresident derives income from sources within the United States, if all of its shareholders are nonresident alien individuals who, by the application of section 211 (a), would not be subject to surtax with respect to distributions of the corporation if made.

For the computation of the surtax see § 29.102–4.

§ 29.102–2 *Purpose to avoid surtax; evidence; burden of proof; definition of holding or investment company.* The Commissioner's determination that a corporation was formed or availed of for the purpose of avoiding the individual surtax is subject to disproof by competent evidence. The existence or nonexistence of the purpose may be indicated by circumstances other than the evidence specified in the Internal Revenue Code, and whether or not such purpose was present depends upon the particular circumstances of each case. In other words, a corporation is subject to taxation under section 102 if it is formed or availed of for the purpose of preventing the imposition of surtax upon shareholders through the medium of permitting earnings or profits to accumulate, even though the corporation is not a mere holding or investment company and does not have an unreasonable accumulation of earnings or profits; and on the other hand, the fact that a corporation is such a company or has such an accumulation is not absolutely conclusive against it if, by clear and convincing evidence, the taxpayer satisfies the Commissioner that the corporation was neither formed nor availed of for the purpose of avoiding the individual surtax. All the other circumstances which might be construed as evidence of the purpose to avoid surtax cannot be outlined, but among other things the following will be considered (1) Dealings between the corporation and its shareholders, such as withdrawals by the shareholder's as personal loans or the expenditure of funds by the corporation for the personal benefit of the shareholders, and (2) the investment by the corporation of undistributed earnings in assets having no reasonable connection with the business. The mere fact that the corporation distributed a large portion of its earnings for the year in question does not necessarily prove that earnings were not permitted to accumulate beyond reasonable needs or that the corporation was not formed or availed of to avoid surtax upon shareholders.

If the Commissioner determines that the corporation was formed or availed of for the purpose of avoiding the individual surtax through the medium of permitting earnings or profits to accumulate, and the taxpayer contests such determination of fact by litigation, the burden of proving the determination wrong by a preponderance of evidence, together with corresponding burden of first going forward with evidence, is on the taxpayer under principles applicable to income tax cases generally, and this is so even though the corporation is not a mere holding or investment company and does not have an unreasonable accumulation of earnings or profits. However, if the corporation is a mere holding or investment company, then the Internal Revenue Code gives further weight to the presumption of correctness already arising from the Commissioner's determination by expressly providing an additional presumption of the existence of a purpose to avoid surtax upon shareholders, while if earnings or profits are permitted to accumulate beyond the reasonable needs of the business, then the Code adds still more weight to the Commissioner's determination by providing that irrespective of whether or not the corporation is a mere holding or investment company, the existence of such an accumulation is determinative of the purpose to avoid surtax upon shareholders unless the taxpayer proves the contrary by such a clear preponderance of all evidence that the absence of such a purpose is unmistakable.

A corporation having practically no activities except holding property, and collecting the income therefrom or investing therein, shall be considered a holding company within the meaning of section 102. If the activities further include, or consist substantially of, buying and selling stocks, securities, real estate, or other investment property (whether upon an outright or a marginal basis) so that the income is derived not only from the investment yield but also from profits upon market fluctuations, the corporation shall be considered an investment company within the meaning of section 102.

§ 29.102–3 *Unreasonable accumulation of profits.* An accumulation of earnings or profits (including the undistributed earnings or profits of prior years) is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. It is not intended, however, to prevent accumulations of surplus for the reasonable needs of the business if the purpose is not to prevent the imposition of the surtax. No attempt is here made to enumerate all the ways in which earnings or profits of a corporation may be accumulated for the reasonable needs of the business. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in additions to plant reasonably required by the business; or if in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonableness of the accumulations.

The business of a corporation is not merely that which it has previously carried on, but includes in general any line of business which it may undertake. However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to avoid the surtax. If one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance although not in legal form the business of the first corporation. Earnings or profits of the first corporation put into the second through the purchase of stock or otherwise may, therefore, if a subsidiary relationship is established, constitute employment of the income in its own business. Investment by a corporation of its income in stock and securities of another corporation is not of itself to be regarded as employment of the income in its business. The business of one corporation may not be regarded as including the business of another unless the other corporation is a mere instrumentality of the first; to establish this it is ordinarily essential that the first corporation own all or substantially all of the stock of the second.

The Commissioner, or any collector upon direction from the Commissioner, may require any corporation to furnish a statement of its accumulated earnings and profits, the name and address of, and number of shares held by each of its shareholders, and the amounts that would be payable to each, if the income of the corporation were distributed. (See section 148 (c).)

§ 29.102–4 *Computation of undistributed section 102 net income.* In ascertaining the tax basis for corporations subject to the provisions of section 102,

the "section 102 net income" is first computed. This is accomplished in the case of a domestic corporation by subtracting from the corporate net income (as defined in sections 21 and 204) computed without the benefit of the capital loss carry-over provided in section 117 (e) from a taxable year beginning after December 31, 1940, and computed without the net operating loss deduction provided in section 23 (s), (a) Federal income, war-profits, and excess-profits taxes (other than the tax imposed by subchapter E of chapter 2 for a taxable year beginning after December 31, 1940) paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23 (c), but not including the graduated income tax or surtax imposed by section 102 or corresponding sections of prior Revenue Acts; (b) contributions or gifts payment of which is made within the taxable year, not otherwise allowed as a deduction, to or for the use of donees described in section 23 (o) and § 29.23 (o)–1 for the purposes therein specified; (c) losses from sales or exchanges of capital assets which are disallowed as a deduction by section 117 (d) for the taxable year. In the case of a foreign corporation, whether resident or nonresident, which files or causes to be filed a return the "section 102 net income" means the net income from sources within the United States (gross income from sources within the United States, as defined in section 119 and the regulations thereunder, less statutory deductions) minus the amount of the deductions enumerated in (a), (b), and (c) above. In the case of a foreign corporation, whether resident or nonresident, which files no return the "section 102 net income" means the gross income from sources within the United States, as defined in section 119 and the regulations thereunder, without the benefit of the deductions enumerated in (a), (b), and (c) above, or any other deductions. (See section 233.) In the case of a taxable year of less than 12 months on account of a change in the accounting period of the corporation, the corporate net income is computed on the basis of the period included in the taxable year, and is not placed on an annual basis under the provisions of section 47 (c).

The "section 102 net income" includes interest upon obligations of the United States and obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States, except as provided in section 22 (b) (4). The "section 102 net income" does not include interest on obligations of States or Territories of the United States or any political subdivision thereof or of the District of Columbia or of the possessions of the United States.

The "undistributed section 102 net income" is computed by subtracting from the "section 102 net income" described above, the amount of the basic surtax credit provided in section 27 (b). In computing the basic surtax credit for the purpose of section 102, the credit under section 27 (b) (1) is not to be reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

SEC. 103. RATES OF TAX ON CITIZENS AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES [as amended by secs. 163 (b), 172 (c), Rev. Act. 1942].

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 11, 12, 13, 14, 201 (a), 204 (a), 207, 211 (a), 231 (a), 362, and 450 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by sections 11, 12, 13, 14, 201 (a), 204 (a), 207, 211 (a), 231 (a), 362, and 450, as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 per centum of the net income of the taxpayer. Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

SEC. 104. BANKS AND TRUST COMPANIES [as amended by sec. 202, Rev. Act 1939; sec. 104 (c), Rev. Act 1941.]

(a) *Definition.* As used in this section the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, 38 Stat. 262 (U. S. C., Title 12, § 248k), as amended, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions.

(b) *Rate of tax.* Banks shall be subject to tax under section 13 or section 14 (b), and under section 15.

§ 29.104–1 *Tax on banks.* A bank, as defined in section 104 (a), is, under section 104 (b), subject to the tax imposed by section 13 if it has a normal-tax net income of more than $25,000 (see § 29.13–1), or to the tax provided by section 14 (b) if it has a normal-tax net income of not more than $25,000 (see § 29.14–1). Such a bank is also subject to the surtax imposed by section 15 (see § 29.15–1).

SEC. 105. SALE OF OIL OR GAS PROPERTIES.

In the case of a bona fide sale of any oil or gas property, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration or discovery work done by the taxpayer, the portion of the tax imposed by section 12 attributable to such sale shall not exceed 30 per centum of the selling price of such property or interest.

§ 29.105–1 *Surtax on sale of oil or gas properties.* If the taxpayer by prospecting and locating claims, or by exploring or discovering undeveloped claims, has demonstrated the principal value of oil or gas property, which prior to his efforts had a relatively minor value, the portion of the surtax imposed by section 12 attributable to a sale of such property or of the taxpayer's interest therein shall not exceed 30 percent of the selling price. Shares of stock in a corporation owning oil or gas property do not constitute an interest in such property. To determine the application of section 105 to a particular case, the taxpayer should first compute the surtax imposed by section 12 upon his entire surtax net income, including the net income from any sale of such property or interest therein, without regard to section 105. The proportion of the surtax, so computed, indicated by the ratio which the taxpayer's net income from the sale of the property or interest therein, computed as prescribed in this section, bears to his total net income is the portion of the surtax attributable to such sale, and if it exceeds 30 percent of the selling price of such property or interest, such portion of the surtax shall be reduced to that amount.

In determining the portion of the net income attributable to the sale of such oil or gas property or interest therein, the taxpayer shall allocate to the gross income derived from such sale, and to the gross income derived from all other sources, the expenses, losses, and other deductions properly appertaining thereto and shall apply any general expenses, losses, and deductions (which cannot properly be otherwise apportioned) ratably to the gross income from all sources. The gross income derived from the sale of such oil or gas property or interest therein, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the net income attributable to such sale. The taxpayer shall submit with his return a statement fully explaining the manner in which such expenses, losses, and deductions are allocated or apportioned.

SEC. 106. CLAIMS AGAINST UNITED STATES INVOLVING ACQUISITION OF PROPERTY.

In the case of amounts (other than interest) received by a taxpayer from the United States with respect to a claim against the United States involving the acquisition of property and remaining unpaid for more than fifteen years, the portion of the tax imposed by section 12 attributable to such receipt shall not exceed 30 per centum of the amount (other than interest) so received.

§29.106–1 *Surtax on certain amounts received from the United States.* The method of computation provided for in § 29.105–1, relating to the limitation on surtax on the sale of oil or gas properties, shall be applicable in computing, under section 106, the surtax imposed by section 12 attributable to certain amounts received by the taxpayer from the United States under a claim involving acquisition of his property. The surtax limitation provided in section 106 is not applicable to any amount received from the United States which constitutes interest, whether such interest was included in the claim or in any judgment

thereon or has accrued on such judgment.

SEC. 107. COMPENSATION FOR SERVICES RENDERED FOR A PERIOD OF THIRTY-SIX MONTHS OR MORE [as added by sec. 220 (a), Rev. Act 1939, and as amended by sec. 139 (a), Rev. Act 1942.]

(a) *Personal services.* If at least 80 per centum of the total compensation for personal services covering a period of thirty-six calendar months or more (from the beginning to the completion of such services) is received or accrued in one taxable year by an individual or a partnership, the tax attributable to any part thereof which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.

(b) *Patent, copyright, etc.* For the purposes of this subsection, the term "artistic work or invention", in the case of an individual, means a literary, musical, or artistic composition of such individual or a patent or copyright covering an invention of or a literary, musical, or artistic composition of such individual, the work on which by such individual covered a period of thirty-six calendar months or more from the beginning to the completion of such composition or invention. If, in the taxable year, the gross income of any individual from a particular artistic work or invention by him is not less than 80 per centum of the gross income in respect of such artistic work or invention in the taxable year plus the gross income therefrom in previous taxable years and the twelve months immediately succeeding the close of the taxable year, the tax attributable to the part of such gross income of the taxable year which is not taxable as a gain from the sale or exchange of a capital asset held for more than 6 months shall not be greater than the aggregate of the taxes attributable to such part had it been received ratably over that part of the period preceding the close of the taxable year but not more than thirty-six calendar months.

(c) *Fractional parts of a month.* For the purposes of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

§ 29.107–1 *Personal services.* Section 107 (a) provides that if at least 80 percent of the total compensation for personal services covering a period of 36 calendar months or more (from the beginning to the completion of such services) is received or accrued in one taxable year by an individual or a partnership, then the tax attributable to any part of such amount which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had such part been included in the gross income of such individual ratably over that part of the period of service which precedes the date of such receipt or accrual. Thus, for example, if an individual who makes his returns on a calendar year basis and on the basis of cash receipts and disbursements commences personal services on February 17, 1942, and completes them on July 1, 1945, and is paid $8,000 for such services on the completion date, he is entitled to the benefits of section 107 (a), provided the $8,000 is at least 80 percent of the total compensation paid or to be paid to such individual for such services; and the tax attributable to the $8,000 received in 1945 and included in the individual's gross income for such year shall not be greater than the tax attributable to such amount, had it been received ratably over the calendar months included in the period from February 17, 1942, to July 1, 1945. However, if such individual receives an additional $5,000 in 1946 for such services, he is not entitled to the benefits of section 107 (a) with respect to either the $8,000 or the $5,000, for the reason that he does not receive in one taxable year at least 80 percent of the total compensation for such services. Also, for example, if an individual who makes his returns on the calendar year basis and on the basis of cash receipts and disbursements commences personal services on March 3, 1940, and completes them on August 22, 1943, and is paid a total compensation of $10,000 for such services on July 5, 1942, he is entitled to the benefits of section 107 (a); and the tax attributable to the $10,000 received in 1942 and included in such individual's gross income for such year shall not be greater than the tax attributable to such amount, had it been received ratably over the calendar months included in the period from March 3, 1940, to July 5, 1942, the date on which the $10,000 was received. However, if such individual receives an additional $7,000 for such services on May 1, 1943, he is not entitled to the benefits of section 107 (a) for the reason that he does not receive in one taxable year at least 80 percent of the total compensation for such services.

It is immaterial when the personal services are rendered provided at least 36 calendar months elapse from the beginning to the completion of the services. For the purposes of this section, a fractional part of a month is to be disregarded unless it amounts to more than half a month, in which case it is to be considered as a month.

It is not necessary, in order for section 107 (a) to be applicable, that the individual who includes in his gross income compensation for such personal services be the person who renders the services. For example, a partner who shares in the compensation for such personal services rendered by the partnership may be entitled to the benefits of section 107 (a), notwithstanding that he took no part in the rendering of such services.

The first step in determining whether the limitation in section 107 (a) relative to the amount of tax is applicable is the computation of the amount of tax in the current taxable year attributable to that part of the compensation which is included in the gross income of the taxpayer for such year. The tax attributable to such compensation is the difference between the tax for such taxable year computed with the inclusion of such compensation in gross income and the tax for such taxable year computed without including such compensation in gross income.

The next step is to compute the tax attributable to such compensation in each of the taxable years (including the current taxable year) within which falls one or more calendar months included in the part of the period of service which precedes the date such compensation is received or accrued, as if the compensation had been received or accrued in equal portions in each of such calendar months. For what constitutes a taxable year, see section 48 (a). The amount of the tax attributable to such compensation in each such taxable year is the difference between the tax for such year computed with the inclusion of an allocable portion of such compensation in gross income and the tax for such year computed without including any part of such compensation in gross income. The portion of the compensation allocable to each such taxable year is an amount equal to the entire amount of such compensation received or accrued in the current taxable year, divided by the entire number of calendar months included within the part of the period of service which precedes the date such compensation is received or accrued, and multiplied by the number of such calendar months falling within the particular taxable year.

The tax for the current taxable year shall be the tax for such year computed without including the compensation for personal services in gross income, plus (1) the amount of tax for such taxable year attributable to such compensation (computed in accordance with the second preceding paragraph) or (2) the sum of the taxes attributable to such compensation had it been received in equal portions in each of the calendar months included within the part of the period of service which precedes the date such compensation is received or accrued (computed in accordance with the preceding paragraph), which ever is the smaller.

The method of allocating compensation for personal services to the taxable years in which falls any of the calendar months included within the part of the period of service which precedes the date such compensation is received may be illustrated by the following examples, in each of which the taxpayer makes his return on the cash receipts and disbursements basis:

Example (1). On November 1, 1942, A, an individual, who makes his income tax returns on a calendar year basis, receives $40,000, the entire compensation for the performance of personal services covering a 40-month period beginning on June 1, 1939, and ending on September 30, 1942. For the purpose of determining whether the aggregate of the taxes attributable to the $40,000 compensation, had it been received in equal portions in each of the calendar months included within the part of the period of service which precedes the date the compensation is received (in this case the entire period of service), is less than the tax attributable to such compensation in the taxable year 1942, $1,000 ($40,000 divided by 40) must be allocated to each of the calendar months included within the period of service. Thus, $7,000 is allocated to 1939, $12,000 to 1940, $12,000 to 1941, and $9,000 to 1942 (the current taxable year).

Example (2). Assume the same facts as in example (1) except that A makes his income tax returns on the basis of the fiscal year July 1 to June 30. The $40,000 is allocated as follows: $1,000 to the taxable year ended June 30, 1939, $12,000 each to the taxable years ended June 30, 1940, June 30, 1941, and June 30, 1942, and $3,000 to the taxable year ending June 30, 1943 (the current taxable year).

Example (3). Assume the same facts as in example (1) except that A receives the $40,000 on February 1, 1942 (before completion of the services), instead of November 1, 1942. There are 32 calendar months included within the part of the period of service which precedes the date the compensation is received. Accordingly, $1,250 ($40,000 divided by 32) must be allocated to each of the calendar months included within the period from June 1, 1939, to February 1, 1942. Thus $8,750 is allocated to 1939, $15,000 to 1940, $15,000 to 1941, and $1,250 to 1942 (the current taxable year).

Example (4). B, an individual, who makes his income tax returns on a calendar year basis, renders personal services covering a 40-month period beginning on May 1, 1939, and ending on August 31, 1942. The total compensation for such services is $74,000, of which $34,000 is paid to B on March 1, 1942, and $40,000 on August 31, 1942. Using the method of allocation illustrated in example (1), the $40,000 payment must be allocated to the 40 calendar months included within the entire period of service. Accordingly, with respect to the $40,000 payment, $8,000 is allocated to 1939, $12,000 to 1940, $12,000 to 1941, and $8,000 to 1942 (the current taxable year). Using the method of allocation illustrated in example (3), the $34,000 payment must be allocated to the 34 calendar months included within the part of the period of service which precedes the date such payment is received (March 1, 1942). Accordingly, with respect to the $34,000 payment, $8,000 is allocated to 1939, $12,000 to 1940, $12,000 to 1941, and $2,000 to 1942 (the current taxable year). The entire compensation of $74,000 will, therefore, be allocated as follows: $16,000 to 1939, $24,000 to 1940, $24,000 to 1941, and $10,000 to 1942 (the current taxable year).

If an individual, in computing his income tax for a particular taxable year, avails himself of the benefits of section 107 (prior or subsequent to its amendment by section 139 of the Revenue Act of 1942) with respect to compensation received or accrued in such year for personal services, and in a subsequent taxable year receives or accrues compensation for other personal services, all or a part of the period of which services is the same as the period of the services for which he was compensated in the previous taxable year, then he must, in availing himself of the benefits of section 107 for such subsequent taxable year, take into consideration the fact that he has previously allocated compensation to all or a part of the period of service. For example, an individual commences the performance of personal services for A on January 1, 1937, and completes them on December 31, 1941. On December 31, 1941, he receives $60,000 in full compensation therefor. In his return for the calendar year 1941, he allocates $1,000 to each of the 60 calendar months included within the period of service and determines his income tax under the provisions of section 107 (a). He also commences the performance of personal services for B on January 1, 1939, and completes them on December 31, 1942. On December 31, 1942, he receives $48,000 in full compensation therefor. If he wishes to avail himself of the benefits of section 107 (a) in his return for the calendar year 1942, he must, in allocating $1,000 to each of the 48 calendar months included within the period of service and computing the tax attributable thereto, include in his income for the years 1939, 1940, and 1941, for the purposes of the tentative computation, the amount of $12,000 previously allocated to each of such years in his return for the calendar year 1941.

§ 29.107–2 *Artistic work or invention.* Section 107 (b) provides that the gross income of an individual from an artistic work or invention of such individual covering a period of 36 calendar months or more (from the beginning to the completion thereof) is not less than 80 percent of the sum of (1) the gross income therefrom in the taxable year, and (2) the gross income therefrom in previous taxable years and in the 12 months following the close of the taxable year, then the tax attributable to such gross income in the taxable year shall not be greater than the aggregate of the taxes attributable thereto had it been received ratably over (1) the part of the period of the work which precedes the close of the taxable year, or (2) a period of 36 calendar months, whichever of such periods is the shorter. That part of the gross income from such artistic work or invention which is taxable as a gain from the sale or exchange of a capital asset held for more than six months is excluded from the benefits of section 107 (b).

For the purposes of this section, the term "artistic work or invention" means a literary, musical, or artistic composition, or a patent or copyright covering an invention or a literary, musical, or artistic composition. Also, for the purposes of this section, a fractional part of a month is to be disregarded unless it amounts to more than half a month, in which case it is to be considered as a month.

The first step in determining whether the limitation in section 107 (b) relative to the amount of tax is applicable is the computation of the amount of tax in the current taxable year attributable to the gross income received or accrued in such year from the artistic work or invention. The tax attributable to such income is the difference between the tax for such taxable year computed with the inclusion in gross income of the gross income from the artistic work or invention and the tax for such taxable year computed without including in gross income the gross income from the artistic work or invention.

The next step is to compute the tax attributable to the gross income from the artistic work or invention in each of the taxable years (including the current taxable year) within which falls one or more of the calendar months included within the part of the period of work which precedes the close of the current taxable year (not, however, exceeding 36 calendar months), as if the gross income from the artistic work or invention had been received or accrued in equal portions in each of such calendar months. For what constitutes a taxable year, see section 48 (a). The amount of tax attributable to gross income in each such taxable year from the artisic work or invention is the difference between the tax for such year computed with the inclusion in gross income of the gross income from the artistic work or invention and the tax for such year computed without including in gross income any part of the gross income from the artistic work or invention. The portion of the gross income from the artistic work or invention allocable to each such taxable year is an amount equal to the entire amount of the gross income from the artistic work or invention received or accrued in the current taxable year, divided by the entire number (not to exceed 36) of calendar months included within the part of the period of work which precedes the close of the current taxable year, and multiplied by the number of such calendar months falling within the particular taxable year.

The tax for the current taxable year shall be the tax for such year computed without including in gross income the gross income from the artistic work or invention, plus whichever of the following is the smaller: (1) The amount of tax for such taxable year attributable to the gross income from the artistic work or invention (computed in accordance with the second preceding paragraph) or (2) the sum of the taxes attributable to the gross income from the artistic work or invention had it been received in equal portions in each of the calendar months (not exceeding 36 calendar months) included within the part of the period of work which precedes the close of the current taxable year (computed in accordance with the preceding paragraph).

The method of allocating the gross income from the artistic work or invention to the taxable years in which falls any of the calendar months (not exceeding 36 calendar months) included within the part of the period of work which precedes the close of the current taxable year may be illustrated by the following examples:

Example (1). On October 1, 1942, A, an individual, who makes his returns on a calendar year basis and on the basis of cash receipts and disbursements, receives $36,000 in full payment for a musical composition, the work on which was commenced by A on July 10, 1938, and completed on January 29, 1943. Although the period of work covers 55 calendar months, allocations may be made to only the last 36 calendar months included within the part of the period of work which precedes the close of 1942 (the current taxable year). Therefore, $1,000 ($36,000 divided by 36) must be allocated to each of the 36 calendar months preceding January 1, 1943. Accordingly, $12,000 is allocated to 1940, $12,000 to 1941, and $12,000 to 1942 (the current taxable year).

Example (2). Assume the same facts as in example (1) except that the period of work was commenced by A on July 1, 1941, and completed on September 1, 1944. Although the period of work covers 38 calendar months, allocations may be made to only the 18 calendar months which are included within the part of the period of work which precedes the close of 1942 (the current taxable year). Therefore, $2,000 ($36,000 divided by 18) must be allocated to each of 18 calendar months preceding January 1, 1943. Accordingly, $12,000 is allocated to 1941, and $24,000 to 1942 (the current taxable year).

The principles set forth in the last paragraph of § 29.107–1, relating to the manner of allocating compensation for personal services to a particular calendar month where an allocation for other

such services has previously been made to such month, are also applicable with respect to allocations under section 107 (b).

SEC. 108 [Added by sec. 140 (a), Rev. Act 1942—not applicable to taxable years beginning after December 31, 1941].

SEC. 109. WESTERN HEMISPHERE TRADE CORPORATIONS [as added by sec. 141, Rev. Act 1942].

For the purposes of this chapter, the term "western hemisphere trade corporation" means a domestic corporation all of whose business is done in any country or countries in North, Central, or South America, or in the West Indies, or in Newfoundland and which satisfies the following conditions:

(a) If 95 per centum or more of the gross income of such domestic corporation for the three-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) was derived from sources other than sources within the United States; and

(b) If 90 per centum or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

§ 29.109–1 *Western hemisphere trade corporations.* Under the provisions of section 15 a domestic corporation qualifying as a Western Hemisphere trade corporation is exempt from the surtax imposed upon corporations generally by section 15. To so qualify, the following tests must be met:

(a) Its entire business must be carried on within the geographical limits of North, Central, or South America, or in the West Indies, or in Newfoundland; and

(b) 95 percent or more of its gross income for the 3-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) must be derived from sources without the United States; and

(c) 90 percent or more of its gross income for such period or such part thereof must be derived from the active conduct of a trade or business.

A domestic corporation is not excluded from the exemption merely because, incident to the conduct of its trade or business, it retains title in goods to insure payment for such goods shipped to a country outside the geographical areas enumerated in section 109.

A corporation which claims exemption as a Western Hemisphere trade corporation shall attach to its income tax return a statement showing that its entire business is done in one or more of the designated countries, and for the 3-year period immediately preceding the close of the taxable year (or for such part thereof during which the corporation was in existence) (1) its total gross income from all sources, (2) the amount thereof derived from the active conduct of a trade or business, (3) a description of such trade or business and the facts upon which the corporation relies to establish that such trade or business was actively conducted by it, and (4) the amount of its gross income, if any, from sources within the United States. The gross income from sources without the United States and within the United States shall be determined as provided in section 119 and the regulations prescribed thereunder.

COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of gain or loss.* The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.* The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of gain or loss.* In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this chapter, shall be determined under the provisions of section 112.

(d) *Installment sales.* Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

§ 29.111–1 *Computation of gain or loss.* Except as otherwise provided, the Internal Revenue Code regards as income or as loss sustained, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent. The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property which is received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. The general method of computing such gain or loss is prescribed by section 111, which contemplates that from the amount realized upon the sale or exchange there shall be withdrawn a sum sufficient to restore the adjusted basis prescribed by section 113 (b) and §§ 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive (i. e., the cost or other basis provided by section 113 (a), adjusted for receipts, expenditures, losses, allowances, and other items chargeable against and applicable to such cost or other basis). The amount which remains after the adjusted basis has been restored to the taxpayer constitutes the realized gain. If the amount realized upon the sale or exchange is insufficient to restore to the taxpayer the adjusted basis of the property, a loss is sustained in the amount of the insufficiency. The basis may be different depending upon whether gain or loss is being computed.

Even though property is not sold or otherwise disposed of, gain (includible in gross income under section 22 (a) as "gains or profits and income derived from any source whatever") is realized if the sum of all the amounts received which are required by section 113 (b) to be applied against the basis of the property exceeds such basis. On the other hand, a loss is not ordinarily sustained prior to the sale or other disposition of the property, for the reason that until such sale or other disposition occurs there remains the possibility that the taxpayer may recover or recoup the adjusted basis of the property. Until some identifiable event fixes the actual sustaining of a loss and the amount thereof the Internal Revenue Code takes no account of it. The provisions of this paragraph may be illustrated by the following example:

Example. A purchased certain shares of stock subsequent to February 28, 1913, for $10,000. On January 1, 1942, A's adjusted basis for the stock had been reduced to $1,000, by reason of receipts and distributions described in section 113 (b) (1) (A) and (D). He received in 1942 a further distribution of $5,000, being a distribution described in section 113 (b) (1) (D). This distribution applied against the adjusted basis as required by section 113 (b) (1) (D) exceeds that basis by $4,000. The amount of the excess, namely, $4,000, is a gain realized by A in 1942 includible, as a gain from the stock, in gross income in his return for that calendar year. In computing gain from the stock, as in adjusting basis, no distinction is made between items of receipts or distributions described in section 113 (b). If A sells the stock in 1943 for $5,000, he realizes in 1943 a gain of $5,000, since the adjusted basis of the stock for the purpose of computing gain or loss from the sale is zero.

In the case of property sold on the installment plan, special rules for the taxation of the gain are prescribed in section 44.

SEC. 112. RECOGNITION OF GAIN OR LOSS [as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

(a) *General rule.* Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

§ 29.112 (a)–1 *Sales or exchanges.* The extent to which the amount of gain or loss, determined under section 111, from the sale or exchange of property is to be recognized is governed by the provisions of section 112. The general rule is that the entire amount of such gain or loss is to be recognized.

An exception to the general rule is made by section 112 (b) (1) to (5), inclusive, in the case of certain specifically described exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property acquired, but such differences are more formal than substantial. As to these, the Internal Revenue Code provides that such differences shall not be deemed controlling, and that gain or loss shall not be recognized at the time of the exchange. The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated.

The Internal Revenue Code makes specific provision for the case in which, in addition to property which may be received tax free on the exchange, there is received as boot other property or money.

In such a case gain is recognized to the extent of the boot (see section 112 (c) and (d)), but no loss of any kind is recognized (see section 112 (e)).

The exceptions from the general rule requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Internal Revenue Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

To constitute an exchange within the meaning of section 112 (b) (1) to (5), inclusive, the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

See section 112 (b) (6) with respect to nonrecognition of gain or loss upon the receipt of property distributed in complete liquidation of a corporation under certain specifically described circumstances. See sections 112 (b) (8) and 371 with respect to nonrecognition of gain or loss upon exchanges and distributions made in obedience to orders of the Securities and Exchange Commission. See section 510 of the Merchant Marine Act of 1936, as added by section 7 of the Act of August 4, 1939 (53 Stat. 1183), with respect to nonrecognition of gain in case of the transfer of an obsolete vessel to the Maritime Commission under the provisions of such section.

§ 29.112 (a)-2 *Use of term "assumption of liabilities."* When used in the regulations prescribed under sections 112 and 113, the terms "assumption of liabilities," "liablities assumed," or similar expressions include, in addition to cases where personal liabilities of the taxpayer are assumed by another party to the exchange, cases (1) where property of the taxpayer is acquired by another party to the exchange subject to a liability, whether or not the taxpayer was himself personally liable, and (2) where, though the property transferred was held by the taxpayer merely subject to a liability, the liability is assumed by another party to the exchange.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142(a), 151(d) (e), Rev. Act 1942.]

(b) *Exchanges solely in kind—(1) Property held for productive use or investment.* No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held for productive use in trade or business or for investment.

§ 29.112 (b) (1)-1 *Property held for productive use in trade or business or for investment.* As used in section 112 (b) (1), the words "like kind" have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under such section, be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for such fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than dealer for future use or future realization of the increment in value is held for investment and not primarily for sale.

No gain or loss is recognized if (1) a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of like kind for the same use, such as a truck for a new truck or a passenger automobile for a new passenger automobile to be used for a like purpose, or (2) a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or a leasehold of a fee with 30 years or more to run for real estate, or improved real estate for unimproved real estate, or (3) a taxpayer exchanges investment property and cash for investment property of a like kind.

A transfer is not within the provisions of section 112 (b) (1) if as part of the consideration the other party to the exchange assumes a liability of the taxpayer, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

Gain or loss is recognized if a taxpayer exchanges (1) Treasury bonds maturing October 15, 1945, for Treasury bonds maturing June 15, 1963, or (2) a real estate mortgage for bonds of the Home Owners' Loan Corporation.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

[(b) *Exchanges solely in kind—*]

(2) *Stock for stock of same corporation.* No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

§ 29.112 (b) (2)-1 *Stock for stock of the same corporation.* The exchange, without the recognition of gain or loss, of common stock for common stock, or of preferred stock for preferred stock, in the same corporation is not limited to a transaction between a stockholder and the corporation; it includes an exchange between two individual stockholders. However, the provisions of section 112 (b) (2) do not apply if stock is exchanged for bonds, or preferred stock is exchanged for common stock, or common stock is exchanged for preferred stock, or common stock in one corporation is exchanged for common stock in another corporation.

A transfer is not within the provisions of section 112 (b) (2) if as part of the consideration the other party to the exchange assumes a liability of the taxpayer, but such transfer, if otherwise qualified, will be within the provisions of section 112 (c).

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

[(b) *Exchanges solely in kind—*]

(3) *Stock for stock on reorganization.* No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same; gain of corporation.* No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.* No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. Where the transferee assumes a liability of a transferor, or where the property of a transferor is transferred subject to a liability, then for the purpose only of determining whether the amount of stock or securities received by each of the transferors is in the proportion required by this paragraph, the amount of such liability (if under subsection (k) it is not to be considered as "other property or money") shall be considered as stock or securities received by such transferor.

§ 29.112 (b) (5)-1 *Transfer of property to corporation controlled by transferor.* As used in section 112 (b) (5), the phrase "one or more persons" includes individuals, trusts or estates, partnerships and corporations (see section 3797); and to be in "control" of the transferee corporation such person or persons must own immediately after the transfer stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation. (See section 112 (h).) The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure.

Example (1). A owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $150,000 in 1942. He transfers this property to the M. Corporation, a newly formed company, for all the latter's capital stock. No gain or loss is recognized on the transaction.

Example (2). C owns a patent right worth $25,000 and D owns a manufacturing plant worth $75,000. C and D organize the R Corporation with an authorized capital stock of $100,000. C transfers his patent right to the R Corporation for $25,000 of its stock and D transfers his plant to the new corporation for $75,000 of its stock. No gain or loss to C or D is recognized.

Example (3). B owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $200,000 in 1942. He transfers the property to the N Corporation in 1942 for 78 percent of each class of stock of the corporation, the remaining 22 percent of the stock of the corporation having been issued by the corporation in 1933 to other persons for cash. B realizes a taxable gain of $150,000 on this transaction. (See section 112 (h).)

§ 29.112 (b) (5)–2 *Treatment of assumptions of liabilities*—(a) *Recognition of gain.* For the effect upon the recognition of gain of an assumption of liabilities in a transfer described in section 112 (b) (5), see section 112 (k) and the regulations prescribed thereunder.

(b) *Computation of proportionate interests required by section 112 (b) (5).* In any case where an assumption of liabilities is not to be treated as "other property or money" under section 112 (k), the liabilities so assumed are, for the purpose of determining whether the stock or securities received by the transferors are sustantially proportionate to their interests in the property transferred as required by section 112 (b) (5), to be treated as stock or securities received by the transferor whose indebtedness is assumed. The application of this paragraph may be illustrated by the following example:

Example. A and B, individuals, each owns property with a fair market value of $100,000 on July 1, 1942. There is a purchase money mortgage on A's property of $50,000. On July 1, 1942, A and B organize the X Corporation, to which they transfer the property above described for the entire capital stock of the X Corporation and the assumption by the X Corporation of A's purchase money mortgage. The X Corporation's capital stock is divided as follows: $50,000 to A and $100,000 to B. Nevertheless, for the purposes of determining whether the transferors received stock or securities substantially in proportion to their interests in the properties transferred, as required by section 112 (b) (5), A is deemed to have received stock or securities to the extent of $100,000, since his $50,000 purchase money mortgage, assumed by the X Corporation, is also to be treated as stock or securities received by him. Accordingly, under the facts as stated, the proportions required by section 112 (b) (5) exist.

§ 29.112 (b) (5)–3 *Records to be kept and information to be filed.* Every person who receives the stock or securities of a controlled corporation for property under section 112 (b) (5) shall file with his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including:

(a) A description of the property transferred, or of his interest in such property, together with a statement of the cost or other basis thereof, adjusted to the date of the transfer, and

(b) A statement of the amount of stock or securities and other property or money received in the exchange, including any liabilities of the taxpayer assumed by the controlled corporation. The amount of each kind of stock or securities and other property received shall be set forth at its fair market value at the date of the exchange.

Every such controlled corporation shall file with its income tax return for the taxable year in which the exchange takes place:

(1) A full description of all property received from the transferors, together with a statement of the cost or other basis thereof in the hands of the transferors adjusted to the date of the transfer, and

(2) A statement of the amount of stock or securities and other property or money which passed to the transferors in the transaction (including any liabilities assumed by such controlled corporation), together with a full statement of the amount of the issued and outstanding stock and securities of such controlled corporation immediately after the exchange and of the ownership of each transferor of each class of stock of such controlled corporation immediately after the exchange (showing as to each class the number of shares and percentage owned and the voting power of each share).

Permanent records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange under section 112 (b) (5) showing the cost or other basis in his hands of the transferred property, and of the amount of stock or securities and other property or money received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received in the exchange.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

[(b) *Exchanges solely in kind*—]

(6) *Property received by corporation on complete liquidation of another.* No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer.

§ 29.112 (b) (6)–1 *Distributions in liquidation of subsidiary corporation*—(a) *General.* Under the general rule prescribed by section 115 (c) for the treatment of distributions in liquidation of a corporation, amounts received by one corporation in complete liquidation of another corporation are treated as in full payment in exchange for stock in such other corporation, and gain or loss from the receipt of such amounts is to be determined as provided in section 111. The scope of this treatment is governed by the meaning of the term "amounts distributed in complete liquidation of a corporation" as used in section 115 (c). Section 112 (b) (6) excepts from the general rule property received, under certain specifically described circumstances, by one corporation as a distribution in complete liquidation of an-

other corporation and provides for the nonrecognition of gain or loss in these cases which meet the statutory requirements. Section 112 (i) places a limitation on the application of section 112 (b) (6) in the case of foreign corporations. See § 29.113 (a) (15)–1 for the basis for determining gain or loss from the subsequent sale of property received upon complete liquidations such as described in this section.

(b) *Requirements for nonrecognition of gain or loss.* The nonrecognition of gain or loss is limited to the receipt of such property by a corporation which is the actual owner of stock (in the liquidating corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends). The Internal Revenue Code expressly requires that the recipient corporation must have been the owner of the specified amount of such stock on the date of the adoption of the plan of liquidation and have continued so to be at all times until the receipt of the property. The Code also expressly requires that the recipient corporation shall at no time, on or after the date of the adoption of the plan and until the receipt of the property, be the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property. If the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation and if the failure to continue qualified occurs at any time prior to the completion of the transfer of all the property, the provisions for the nonrecognition of gain or loss do not apply to any distribution received under the plan.

The provisions of section 112 (b) (6) do not apply to any liquidation if any distribution in pursuance thereof has been made before the first day of the first taxable year of the recipient corporation beginning after December 31, 1935.

To constitute a distribution in complete liquidation within the meaning of section 112 (b) (6), the distribution must be (1) made by the liquidating corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation or (2) one of a series of distributions in complete cancellation or redemption of all its stock in accordance with a plan of liquidation. It is essential that a status of liquidation exist at the time the first distribution is made under the plan and that such status continue to the date of dissolution of the corporation. A status of liquidation exists when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its shareholders. A liquidation may be completed prior to the actual dissolution of the liquidating corporation but no liquidation is completed until the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible). (See § 29.22 (a)–20.)

If a transaction constitutes a distribution in complete liquidation within the meaning of the Internal Revenue Code and satisfies the requirements of section 112 (b) (6), it is not material that it is otherwise described under the local law. If a liquidating corporation distributes all of its property in complete liquidation and if pursuant to the plan for such complete liquidation a corporation owning the specified amount of stock in the liquidating corporation receives property constituting amounts distributed in complete liquidation within the meaning of the Code and also receives other property attributable to shares not owned by it, the transfer of the property to the recipient corporation shall not be treated, by reason of the receipt of such other property, as not being a distribution (or one of a series of distributions) in complete cancellation or redemption of all of the stock of the liquidating corporation within the meaning of section 112 (b) (6), even though for purposes of those provisions in section 112 relating to reorganizations the amount received by the recipient corporation in excess of its ratable share is regarded as acquired upon the issuance of its stock or securities in a tax-free exchange as described in section 112 (b) (4) and the cancellation or redemption of the stock not owned by the recipient corporation is treated as occurring as a result of a tax-free exchange described in section 112 (b) (3). The application of this paragraph may be illustrated by the following example:

Example. On July 1, 1942, the M Corporation had outstanding capital stock consisting of 3,000 shares of common stock, par value $100 a share, and 1,000 shares of preferred stock, par value $100 a share, which preferred stock was limited and preferred as to dividends and had no voting rights. On July 1, 1942, and thereafter until the date of dissolution of the M Corporation, the O Corporation owned 2,500 shares of the common stock of the M Corporation. By a statutory merger consummated on August 1, 1942, pursuant to a plan of liquidation adopted on July 1, 1942, the M Corporation was merged into the O Corporation, the O Corporation under the plan issuing stock which was received by the holders of the stock of the M Corporation not owned by the O Corporation in exchange for their stock in the M Corporation. The receipt by the O Corporation of the properties of the M Corporation is a distribution received by the O Corporation in complete liquidation of the M Corporation within the meaning of section 112 (b) (6), and no gain or loss is recognized as the result of the receipt of such properties.

§ 29.112 (b) (6)–2 *Liquidations completed within one taxable year.* If in a liquidation completed within one taxable year, pursuant to a plan of complete liquidation, distributions in complete liquidation are received by a corporation which owns the specified amount of stock in liquidating corporation and which continues qualified with respect to the ownership of such stock until the transfer of all the property within such year is completed (see § 29.112 (b) (6)–1), then no gain or loss shall be recognized with respect to the distributions received by the recipient corporation. In such case no waiver or bond is required of the recipient corporation under section 112 (b) (6).

§ 29.112 (b) (6)–3 *Liquidations covering more than one taxable year.* If the plan of liquidation is consummated by a series of distributions covering a period of more than one taxable year, the nonrecognition of gain or loss with respect to the distributions in liquidation shall, in addition to the requirements of § 29.112 (b) (6)–1, be subject to the following requirements:

(a) In order for the distribution in liquidation to be brought within the exception provided in section 112 (b) (6) to the general rule for computing gain or loss with respect to amounts received in liquidation of a corporation, the entire property of the corporation shall be transferred in accordance with a plan of liquidation, which plan shall include a statement showing the period within which the transfer of the property of the liquidating corporation to the recipient corporation is to be completed. The transfer of all the property under the liquidation must be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan.

(b) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall, at the time of filing its return, file with the collector for transmittal to the Commissioner a waiver of the statute of limitations on assessment. The waiver shall be executed on such form as may be prescribed by the Commissioner and shall extend the period for assessment of all income and profits taxes for each such year to a date not earlier than one year after the last date of the period for assessment of such taxes for the last taxable year in which the transfer of the property of the liquidating corporation to the controlling corporation may be completed in accordance with section 112 (b) (6). Such waiver shall also contain such other terms with respect to assessment as may be considered by the Commissioner to be necessary to insure the assessment and collection of the correct tax liability for each year within the period of liquidation.

(c) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall file a bond, the amount of which shall be fixed by the Commissioner. The bond shall contain all terms specified by the Commissioner, including provisions unequivocally assuring prompt payment of the excess of income and profits taxes (plus penalty, if any, and interest) as computed by the Commissioner without regard to the provisions of sections 112 (b) (6) and 113 (a) (15) over such taxes computed with regard to such provisions, regardless of whether such excess may or may not be made the subject of a notice of deficiency under section 272 and regardless of whether it may or may not

be assessed. Any bond required under section 112 (b) (6) shall have such surety or sureties as the Commissioner may require. However, see section 1126 of the Revenue Act of 1926, as amended, providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. Only surety companies holding certificates of authority from the Secretary as acceptable sureties on Federal bonds will be approved as sureties. The bonds shall be executed in triplicate so that the Commissioner, the taxpayer, and the surety or the depositary may each have a copy.

Pending the completion of the liquidation, if there is a compliance with paragraphs (a), (b), and (c) of this section and § 29.112 (b) (6)–1 with respect to the nonrecognition of gain or loss, the income and profits tax liability of the recipient corporation for each of the years covered in whole or in part by the liquidation shall be determined without the recognition of any gain or loss on account of the receipt of the distributions in liquidation. In such determination, the basis of the property or properties received by the recipient corporation shall be determined in accordance with section 113 (a) (15). (See § 29.113 (a) (15)–1.) However, if the transfer of the property is not completed within the 3-year period allowed by section 112 (b) (6) or if the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation as required by that section, gain or loss shall be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of section 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 29.112 (b) (6)–4 *Distributions in liquidation as affecting minority interests.* Upon the liquidation of a corporation in pursuance of a plan of complete liquidation, the gain or loss of minority shareholders shall be determined without regard to section 112 (b) (6), since it does not apply to that part of distributions in liquidations received by minority shareholders.

§ 29.112 (b) (6)–5 *Records to be kept and information to be filed with return.* (a) Permanent records in substantial form shall be kept by every corporation receiving distributions in complete liquidation within the exception provided in section 112 (b) (6) showing the information required by this section to be submitted with its return. The plan of liquidation must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of each such corporation.

(b) For the taxable year in which the liquidation occurs, or, if the plan of liquidation provides for a series of distributions over a period of more than one year, for each taxable year in which a distribution is received under the plan, the recipient shall file with its return a complete statement of all facts pertinent to the nonrecognition of gain or loss, including:

(1) A certified copy of the plan for complete liquidation, and of the resolutions under which the plan was adopted and the liquidation was authorized, together with a statement under oath showing in detail all transactions incident to, or pursuant to, the plan.

(2) A list of all properties received upon the distribution, showing the cost or other basis of such properties to the liquidating corporation at the date of distribution and the fair market value of such properties on the date distributed.

(3) A statement as to its ownership of all classes of stock of the liquidating corporation (showing as to each class the number of shares and percentage owned and the voting power of each share) as of the date of the adoption of the plan of liquidation, and at all times since, to and including the date of the distribution in liquidation, and the cost or other basis of such stock.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

[(b) *Exchanges solely in kind*—]

(8)[1] *Exchanges and distributions in obedience to orders of Securities and Exchange Commission.* In the case of any exchange or distribution described in section 371, no gain or loss shall be recognized to the extent specified in such section with respect to such exchange or distribution.

(9) *Loss not recognized on certain railroad reorganizations.* No loss shall be recognized if property of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, is transferred, after December 31, 1939, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77 of the National Bankruptcy Act, as amended,

to a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding. The term "reorganization", as used in this paragraph, shall not be limited by the definition of such term in subsection (g).

§ 29.112 (b) (9)–1 *Nonrecognition of loss upon transfer of property of railroad corporation.* For the purpose of section 112 (b) (9), it is unnecessary that the transfer be a direct transfer by the corporation undergoing reorganization or that such reorganization constitute a reorganization within the meaning of section 112 (g). It is sufficient if the transfer is made in pursuance of an order of the court and is an integral step in the consummation of a plan of reorganization approved by the court having jurisdiction of the proceeding. If these conditions are satisfied, no loss is recognized to the transferor upon the ultimate transfer of the property, or to the transferor upon any intermediate transfer.

[1] There is no paragraph (7).

Section 112 (b) (9) applies only to a transfer resulting in a loss and has no application if the transfer therein described results in a gain.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

(c) *Gain from exchanges not solely in kind.* (1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

§ 29.112 (c)–1 *Receipt of other property or money in tax-free exchange not connected with corporate reorganization.* If in any transaction in which (a) property held for investment or productive use in trade or business is exchanged for property of like kind to be held either for productive use or for investment; or (b) common stock is exchanged for common stock, or preferred stock for preferred stock, in the same corporation and not in connection with a corporate reorganization; or (c) property is transferred by one or more persons to a corporation for its stock or securities, within the meaning of section 112 (b) (5), there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then

(1) The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

Example. A, who is not a dealer in real estate, in 1942 exchanges real estate, which he purchased (for investment) in 1921 for $5,000, for other real estate (to be held for productive use in trade or business) which has a fair market value of $6,000, and he receives in addition $2,000 in cash. The gain from the transaction is $3,000, but is recognized only to the extent of the cash received of $2,000.

Consideration received in the form of an assumption of liabilities is to be treated as "other property or money" for the purposes of so much of section 112 (c) as relates to section 112 (b) (1), (2), and (3). As to the proper treatment of such consideration for the purposes of so much of section 112 (c) as relates to section 112 (b) (5), see section 112 (k) and § 29.112 (k)–1.

See section 113 (a) (6) for the basis for determining the gain or loss from the subsequent sale of the property received in exchanges such as described in this section.

As to the receipt of other property or money on an exchange of stock or securities in connection with a reorganization, and as to distributions in pursuance of a plan of reorganization which have the effect of a taxable dividend, see § 29.112 (g)–4.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

(d) *Same—gain of corporation.* If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from exchanges not solely in kind.* If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

§ 29.112 (e)–1 *Nonrecognition of loss.* The Internal Revenue Code provides that in no event shall a loss be recognized from a tax-free exchange of property under section 112 (b) (1) to (5), inclusive, notwithstanding the fact that there is received in the exchange other property or money in addition to property permitted to be received without recognition of gain or loss.

As to the basis of the property received in such an exchange for the purpose of determining gain or loss from the subsequent sale thereof, see section 113 (a) (6).

As to the nonrecognition of loss upon the receipt of property by one corporation in complete liquidation of another corporation under certain specifically described circumstances, see section 112 (b) (6).

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

(f) *Involuntary conversions.* If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily and involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain shall be recognized, but loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain).

§ 29.112 (f)–1 *Reinvestment of proceeds of involuntary conversion.* Upon the involuntary conversion of property described in section 112 (f), no gain is recognized if the provisions of that section are complied with. If any part of the money received as a result of such an involuntary conversion is not expended in the manner provided in section 112 (f), the gain, if any, is recognized to the extent of the money which is not so expended. For example, a vessel purchased by A in 1939 for $100,000 is destroyed by an enemy submarine in 1942, and A receives in 1942 insurance in the amount of $100,000. This money is not expended in the manner provided in section 112 (f), but there is no gain since the insurance does not exceed the basis (disregarding, for the purposes of this example, the adjustment for depreciation). In 1947, A receives an award of $200,000 from the Government on account of the destruction of the vessel. He expends this amount in the manner provided in section 112 (f). The gain in 1947 upon the receipt of this award is recognized to the extent of $100,000, the amount of the money received in 1942 which was not expended in the manner provided in section 112 (f). The loss sustained as a result of an involuntary conversion described in section 112 (f) is recognized. The expenditure in the manner provided in section 112 (f) of money received upon an involuntary conversion is not necessary for the transaction to be considered completed for the purpose of determining such loss.

In order to avail himself of the benefits of section 112 (f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112 (f) cannot be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

The provisions of section 112 (f) are applicable to property used for residential or farming purposes.

The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

There is no investment in property similar in character and devoted to a similar use if:

(a) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(b) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(c) The owner of a requisitioned tug uses the proceeds to buy barges.

It is incumbent upon a taxpayer "forthwith" to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.

§ 29.112 (f)–2 *Replacement funds.* In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately (for example, because of the taxpayer's inability to obtain priorities, or because of other wartime restrictions), he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. See section 1126 of the Revenue Act of 1926, as amended, providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. The estimated additional taxes, for the amount of which the applicant is required to furnish security, should be computed at the rates at which the applicant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against

him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

[SEC. 112. RECOGNITION OF GAIN OR LOSS—as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

(g) *Definition of reorganization.* As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

§ 29.112 (g)–1 *Purpose and scope of exception of reorganization exchanges*—(a) *Purpose.* Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Internal Revenue Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Code, as are required by business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Code are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. The Code recognizes as a reorganization the change (made in a specified way) from a business enterprise conducted by a single corporation to the same business enterprise conducted by a parent and a subsidiary corporation, but not the creation of a temporary subsidiary as a device for the making of an ordinary dividend. The Code recognizes as a reorganization the amalgamation (occuring in a specified way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. Accordingly, under the Code, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale, even though the mechanics of a reorganization have been set up.

(b) *Scope.* The nonrecognition of gain or loss is prescribed for two specifically described types of exchanges, viz: The exchange that is provided for in section 112 (b) (3) in which stock or securities in a corporation a party to the reorganization are, in pursuance of a plan of reorganization, exchanged for the stock or securities in a corporation a party to the same reorganization; and the exchange that is provided for in section 112 (b) (4) in which a corporation a party to the reorganization exchanges property, in pursuance of a plan of reorganization, for stock or securities in another corporation a party to the same reorganization. Section 112 (g) limits the definition of the term "reorganization" to six kinds of transactions and excludes all others. From its context, the term "a party to a reorganization" can only mean a party to a transaction specifically defined as a reorganization by section 112 (g). Certain rules respecting boot received in either of the two types of exchanges provided for in section 112 (b) (3) and (4) are prescribed in sections 112 (c) and 112 (d). Under section 112 (i) a limitation is placed on all these provisions by providing that except under specified conditions foreign corporations shall not be deemed within their scope.

The provisions of the Internal Revenue Code referred to in the preceding paragraph of this paragraph are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112 (g) and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed. Such transaction and such acts must be an ordinary and necessary incident of the conduct of the enterprise and must provide for a continuation of the enterprise. A scheme which involves an abrupt departure from normal reorganization procedure, devised and adopted with reference to a transaction on which the imposition of the tax is imminent, is not a plan of reorganization.

§ 29.112 (g)–2 *Definition of terms.* The application of the term "reorganization" is to be strictly limited to the specific transaction set forth in section 112 (g) (1). The term does not embrace the mere purchase by one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its stockholders in the properties transferred. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange.

The words "statutory merger or consolidation" refer to a merger or a consolidation effected in pursuance of the corporation laws of the United States or a State or Territory or the District of Columbia.

In order to qualify as a "reorganization" under section 112 (g) (1) (B), the acquisition by the acquiring corporation of the required amount of the stock of the other corporation must be in exchange solely for all or a part of the voting stock of the acquiring corporation. If, for example, Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of the required amount of stock of Corporation Y, the transaction is not a "reorganization" under section 112 (g) (1) (B).

The same requirements obtain in the case of section 112 (g) (1) (C), relative to the acquisition by one corporation of substantially all the properties of another corporation, except that for the purpose of determining whether the exchange is solely for voting stock of the acquiring corporation any assumption by the acquiring corporation of liabilities of the other shall be disregarded. Though such an assumption does not prevent an exchange from being solely for voting stock for the purposes of the definition of a reorganization contained in section 112 (g) (1) (C), it may in some cases, however, so alter the character of the transaction as to place the transaction outside the purposes and assumptions of the reorganization provisions. Section 112 (g) (1) (C) does not prevent consideration of the effect of an assumption of liabilities on the general character of the transaction but merely provides that the requirement that the exchange be solely for voting stock is satisfied if the only additional consideration is an assumption of liabilities.

A "recapitalization," and therefore a reorganization, takes place if, for example:

(a) A corporation with $200,000 par value of bonds outstanding, instead of paying them off in cash, discharges them by issuing preferred shares to the bondholders;

(b) There is surrendered to a corporation for cancellation 25 percent of its preferred stock in exchange for no par value common stock;

(c) A corporation issues preferred stock, previously authorized but unissued, for outstanding common stock; or

(d) An exchange is made of a corporation's outstanding preferred stock, having certain priorities with reference

to the amount and time of payment of dividends and the distribution of the corporate assets upon liquidation, for a new issue of such corporation's common stock having no such rights.

The term "a party to a reorganization" includes, in addition to a corporation which performs the specific act constituting the reorganization as described and defined in section 112 (g) (1), only a corporation specified in section 112 (g) (2). Both corporations are parties to the reorganization if under statutory authority Corporation A is merged into Corporation B; and all three of the corporations are parties to the reorganization if, pursuant to statutory authority, Corporations C and D are consolidated into Corporation E. Both corporations are parties to the reorganization if it consists of the transfer by Corporations F and G of part of the assets of Corporation F in exchange for all of the capital stock of Corporation G. Only Corporations H and J are parties to the reorganization if it consists of the acquisition by Corporation H in exchange solely for all or a part of its voting stock of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of Corporation J, even though such acquition by Corporation H is from Corporation K.

The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 112 (g) (1). The term is not to be construed as broadening the definition of "reorganization" as set forth in section 112 (g) (1), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges as are directly a part of the transaction specifically described as a reorganization in section 112 (g) (1). Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 112 (g) (1), but the readjustments involved in the exchanges effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 112 (g) (1) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

As used in section 112, as well as in other provisions of the Internal Revenue Code, if the context so requires, the conjunction "or" denotes both the conjunctive and the disjunctive, and the singular includes the plural. For example, the provisions of the statute are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received.

§ 29.112 (g)-3 *Exchanges solely of stock or securities, or property, solely for stock or securities, in pursuance of plan of reorganization.* No taxable income is received, nor is a deductible loss sustained, if the shareholders in a corporation a party to the following reorganization transactions exchange stock or securities solely for stock or securities of the same corporation, or of another corporation mentioned, or if one of such corporations transfers property to another of the corporations solely for stock or securities of such other corporation, in pursuance of the plan of reorganization:

(a) The merger of Corporation A, in accordance with statutory authority, into Corporation B;

(b) The consolidation, pursuant to statutory authority, of Corporations C and D into Corporation E, a new corporation;

(c) The acquisition by Corporation F, in exchange solely for all or a part of its voting stock, of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of the stock of Corporation G;

(d) The acquisition by Corporation H, in exchange solely for all or a part of its voting stock (disregarding any assumption of liabilities, as prescribed in § 29.112 (g)-2), of substantially all the properties of Corporation I;

(e) The transfer by Corporation J of all or a part of its assets to Corporation K, if immediately after the transfer Corporation J or its stockholders, or both, are in control of Corporation K ("control" for the purpose of this transaction being defined in section 112 (h) as the ownership by Corporation J or its stockholders, or both, of the stock of Corporation K to the extent of at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes thereof); or

(f) The exchange of stock or securities solely for stock or securities of the same corporation in the case of (1) a recapitalization of a corporation, or (2) a mere change in the identity, form, or place of organization of a corporation, however effected.

§ 29.112 (g)-4 *Exchanges in reorganization for stock or securities and other property or money.* If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then

(a) As provided in section 112 (c) (1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property, but

(b) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e).

Example. A, in connection with a reorganization, in 1942, exchanges a share of stock in the X Corporation purchased in 1929 at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $20 in cash. The gain from the transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized.

If the distribution of such other property or money by or on behalf of a corporation in the course of a reorganization has the effect of the distribution of a taxable dividend, then, as provided in section 112 (c) (2), there shall be taxed to each distributee (1) as a dividend, such an amount of the gain recognized on the exchange as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) as a gain from the exchange of property, the remainder of the gain so recognized.

Example. The X Corporation has a capital of $100,000 and earnings and profits of $50,000 accumulated since February 28, 1913. The X Corporation in 1942 transfers all of its assets to the Y Corporation in exchange for the issuance of all of the stock of the Y Corporation and the payment of $50,000 in cash to the stockholders of the X Corporation. A, who owns one share of stock in the X Corporation, for which he in 1929 paid $100, receives a share of stock in the Y Corporation worth $100 and the sum of $50 in cash in addition. A gain of $50 is recognized to A.

If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to the reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, as provided in section 112 (d) (1), if the other property or money received by the Corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corpooration is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized, under the provisions of section 112 (d) (2), in an amount not in excess of the sum of money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized (see section 112 (e)).

For the proper treatment of an assumption of liabilities under section 112 (d) and so much of section 112 (e) as relates to section 112 (b) (4), see section 112 (k) and the regulations prescribed thereunder. For the proper treatment of an assumption of liabilities under so much of section 112 (c) as relates to section 112 (b) (3), see § 29.112 (c)-1.

§ 29.112 (g)-5 *Receipt of stock or securities in reorganization without surrender of stock by shareholder.* Any distribution, though in pursuance of a plan of reorganization, to its shareholders without the surrender of their stock, by or on behalf of a corporation a party to a reorganization, of its stock or securities (other than its own stock, which is not taxable as a dividend under section 115 (f)) or of stock or securities of another corporation a party to the reorganization, shall be taxed to such shareholders as a dividend, within the meaning of section 115, to the extent that the fair market value of such stock or securities at the date of the distribution is not in excess of (1) the earnings or profits of the corporation of the taxable year com-

puted without regard to prior years and (2) the earnings or profits of the corporation accumulated after February 28, 1913, and prior to the taxable year. Any remainder of such fair market value of the stock or securities distributed over the amount of such earnings or profits shall be applied against and used to reduce the basis provided in section 113 of the stock in respect to which the distribution was made; and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. (See § 29.111–1.)

§ 29.112 (g)–6 *Records to be kept and information to be filed with returns.* (a) The plan of reorganization must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of the corporation. Each corporation a party to a reorganization shall file as a part of its return for its taxable year within which the reorganization occurred a complete statement of all facts pertinent to the nonrecognition of gain or loss in connection with the reorganization, including:

(1) A certified copy of the plan of reorganization, together with a statement under oath showing in full the purposes thereof and in detail all transactions incident to, or pursuant to, the plan.

(2) A complete statement of the cost or other basis of all property, including all stock or securities, transferred incident to the plan.

(3) A statement of the amount of stock or securities and other property or money received from the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities and other property received shall be stated on the basis of the fair market value thereof at the date of the exchange.

(4) A statement of the amount and nature of any liabilities assumed upon the exchange.

(b) Every taxpayer, other than a corporation a party to the reorganization, who receives stock or securities and other property or money upon a tax-free exchange in connection with a corporate reorganization shall incorporate in his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including:

(1) A statement of the cost or other basis of the stock or securities transferred in the exchange, and

(2) A statement in full of the amount of stock or securities and other property or money received from the exchange, including any liabilities assumed upon the exchange. The amount of each kind of stock or securities and other property (other than liabilities assumed upon the exchange) received shall be set forth upon the basis of the fair market value thereof at the date of the exchange.

(c) Permanent records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange in connection with a corporate reorganization showing the cost or other basis of the transferred property and the amount of stock or securities and other property or money received (including any liabilities assumed upon the exchange), in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

[SEC. 112. RECOGNITION OF GAIN OR LOSS— as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act. 1942.]

(h) *Definition of control.* As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation

§ 29.112 (h)–1 *Control of corporation.* Section 112 (h) defines the term "control" in reference to the phrase "control of the corporation," as used in section 112 (b) (5) and section 112 (g) (1). It is provided specifically that this definition is limited to the meaning of the term "control" as that term is used in section 112.

[SEC. 112. RECOGNITION OF GAIN OR LOSS— as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rev. Act 1942.]

(i) *Foreign corporations.* In determining the extent to which gain shall be recognized in the case of any of the exchanges described in subsection (b) (3), (4), (5), or (6), or described in so much of subsection (c) as refers to subsection (b) (3) or (5), or described in subsection (d), a foreign corporation shall not be considered as a corporation unless, prior to such exchange, it has been established to the satisfaction of the Commissioner that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

§ 29.112 (i)–1 *Reorganization with, or transfer of property to or from, a foreign corporation.* A foreign corporation will not be considered a corporation to or from which a tax-free transfer of property for stock or securities may be made, or a corporation a party to a reorganization with which a tax-free reorganization exchange may be made, or a corporation a party to or from which a tax-free liquidation distribution may be made, unless, prior to the transfer, exchange, or liquidation, it has been established to the satisfaction of the Commissioner that such transfer, exchange, or liquidation is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. The term "Federal income taxes" includes (1) the excess-profits tax on the net income of a corporation referred to in section 106 of the Revenue Act of 1935, section 402 of the Revenue Act of 1936, and section 602 of the Revenue Act of 1938, (2) the declared value excess-profits tax referred to in section 600 of the Internal Revenue Code, and (3) the excess profits tax imposed by subchapter E of chapter 2 of the Code.

Whether any of the exchanges or distributions referred to in section 112 (i), involving a foreign corporation, is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income or excess-profits taxes, is a question to be determined from the facts and circumstances of each particular case. In any such case if a taxpayer desires to establish that the exchange or distribution is not in pursuance of such a plan, a statement under oath of the facts relating to the plan under which the exchange or distribution is to be made, together with a copy of the plan, shall be forwarded to the Commissioner of Internal Revenue, Washington, D. C., for a ruling. A letter setting forth the Commissioner's determination will be mailed to the taxpayer. If the Commissioner determines that the exchange or distribution is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income or excess-profits taxes, the taxpayer should retain a copy of the Commissioner's letter as authority for treating the foreign corporation as a corporation in determining the extent to which gain is recognized from the exchange or distribution. If the reorganization or the transfer is not carried out in accordance with the plan submitted, the Commissioner's approval will not render the transaction tax-free.

[SEC. 112. RECOGNITION OF GAIN OR LOSS— as amended by sec. 213 (a) (b) (c), Rev. Act 1939; secs. 142 (a), 151 (d) (e), Rec. Act 1942.]

(j) *Installment obligations.* For nonrecognition of gain or loss in the case of installment obligations, see section 44 (d).

(k) *Assumption of liability not recognized.* Where upon an exchange the taxpayer receives as part of the consideration property which would be permitted by subsection (b) (4) or (5) of this section to be received without the recognition of gain if it were the sole consideration, and as part of the consideration another party to the exchange assumes a liability of the taxpayer or acquires from the taxpayer property subject to a liability, such assumption or acquisition shall not be considered as "other property or money" received by the taxpayer within the meaning of subsection (c), (d), or (e) of this section and shall not prevent the exchange from being within the provisions of subsection (b) (4) or (5); except that if, taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer with respect to the assumption or acquisition was a purpose to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose, such assumption or acquisition (in the amount of the liability) shall, for the purposes of this section, be considered as money received by the taxpayer upon the exchange. In any suit or proceeding where the burden is on the taxpayer to prove that such assumption or acquisition is not to be considered as money received by the taxpayer, such burden shall not be considered as sustained unless the taxpayer sustains such burden by the clear preponderance of the evidence.

§ 29.112 (k)–1 *Assumption of liabilities not to be taken into account for purpose of recognizing gain or loss*—(a) *General rule.* Section 112 (k) does not affect the rule that liabilities assumed are to be taken into account for the purpose of computing the amount of gain or loss realized under section 111 upon an exchange. Subject to the exceptions and limitations specified in paragraph (b)

of this section, section 112 (k) provides, however, that:

(1) Liabilities assumed are not to be treated as "other property or money" under section 112 (e) or for the purpose of determining the amount of the realized gain which is to be recognized under section 112 (c) or (d), if the transactions would, but for the receipt of "other property or money," have been exchanges of the type described in section 112 (b) (4) or (5); and

(2) If the only type of consideration received by the transferor in addition to that permitted to be received by section 112 (b) (4) or (5) consists of an assumption of liabilities, the transaction, if otherwise qualified, shall be deemed to be within the provisions of section 112 (b) (4) or (5).

The application of this paragraph may be illustrated by the following example:

Example. A, an individual, transfers to a controlled corporation property with an adjusted basis of $10,000 in exchange for stock of the corporation with a fair market value of $8,000, cash in the amount of $3,000, and the assumption by the corporation of indebtedness of A amounting to $4,000. A's gain is $5,000, computed as follows:

Stock received	$8,000
Cash received	3,000
Liabilities assumed by transferee	4,000
Total consideration received	15,000
Less: Adjusted basis of property transferred	10,000
Gain realized	5,000

Assuming that the transaction falls within section 112 (c) as a transaction which would have been within section 112 (b) (5) but for the receipt of "other property or money," only so much of such $5,000 gain will be recognized as does not exceed the "other property or money" received. Since section 112 (k) provides that an assumption of liabilities shall not constitute "other property or money" for this purpose, the only "other property or money" received is the $3,000 cash, and the $5,000 realized gain will be recognized only to that extent.

(b) *Exceptions and limitations.* The benefits of section 112 (k) do not extend to any exchange involving an assumption of liabilities where it appears that the principal purpose of the taxpayer with respect to such assumption was a purpose to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose. In such cases, the amount of the liabilities assumed shall, for the purpose of determining the amount of gain to be recognized upon the exchange in which the liabilities are assumed, be treated as money received by the taxpayer upon the exchange. In any suit or proceeding where the burden is on the taxpayer to prove that an assumption of liabilities is not to be treated as "other property or money" under section 112 (k), which is the case if the Commissioner determines that the taxpayer's purpose with respect thereto was a purpose to avoid Federal income tax on the exchange or was not a bona fide business purpose and the taxpayer contests such determination by litigation, the taxpayer must sustain such burden by the clear preponderance of the evidence. Thus, the taxpayer must prove his case by such a clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unmistakable.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS [as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942].

(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—

§ 29.113 (a)–1 *Scope of basis for determining gain or loss.* The basis of property for the purpose of determining gain or loss from the sale or other disposition thereof is the unadjusted basis prescribed in section 113 (a), adjusted for the various applicable items specified in section 113 (b). Unless otherwise indicated, the word "basis," as used in this section and §§ 29.113 (a)–2 to 29.113 (a) (21)–1, inclusive, has reference to the unadjusted basis. For special rules for determining the basis for gain or loss in the case of vessels acquired through the Maritime Commission, see sections 510 and 511 of the Merchant Marine Act of 1936, as amended. For special rules for determining the unadjusted basis of property recovered in respect of war losses, see section 127 (d).

§ 29.113 (a)–2 *General rule.* In general, the basis of property is the cost thereof. This rule is subject, however, to the exceptions stated in sections 113 (a) (1) to 113 (a) (21), inclusive.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(1) *Inventory value.* If the property should have been included in the last inventory, the basis shall be the last inventory value thereof.

§ 29.113 (a) (1)–1 *Property included in inventory.* The last inventory value of property which should be included in inventory is the basis of such property. The requirements with respect to the valuation of an inventory are stated in §§ 29.22 (c)–1 to 29.22 (d)–7, inclusive.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(2) *Gifts after December 31, 1920.* If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period prior to the date of the gift as provided in subsection (b) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner.

§ 29.113 (a) (2)–1 *Property transmitted by gift after December 31, 1920.*—(a) *Property included.* Section 113 (a) (2) applies to all property acquired after December 31, 1920, by gift. It does not apply:

(1) To property acquired by devise or bequest (see section 113 (a) (5)); or

(2) To property acquired by an instrument which, under section 113 (a) (5), is to be treated as though it were a will.

Section 113 (a) (2) applies to all gifts of whatever description, whenever and however made, perfected, or taking effect; whether in contemplation of or intended to take effect in possession or enjoyment at or after the donor's death; or whether made by means of the exercise (other than by will) of a power of appointment or revocation, or any other power. Section 113 (a) (2) applies whether the gift was made by a transfer in trust or otherwise.

(b) *Basis.* For the purpose of determining gain, the basis is the same as it would be in the hands of the donor, or the last preceding owner by whom it was not acquired by gift. For the purpose of determining loss, the basis is as so determined, except that in any case in which such basis, adjusted for the period prior to the date of the gift as provided in section 113 (b), is greater than the fair market value of the property at the time of the gift, the basis is such fair market value.

All titles to property acquired by gift relate back to the time of the gift, even though the interest of him who takes the title was, at the time of the gift, legal, equitable, vested, contingent, conditional, or otherwise. Accordingly, all property acquired by gift is acquired at the time of the gift. In the hands of every person acquiring property by gift, the basis is always the same, whether such person receives the property immediately upon the transfer by the donor, or as remainderman under the instrument of gift, or whether such person is any other person to whom such uniform basis is applicable. Such uniform basis applies to the property in the hands of the trustee or the beneficiary under a gift instrument, both during the term of the trust and after the distribution of the trust corpus. Adjustments to basis, as required by section 113 (b), are to be made as respects the period prior to the gift, and the period after the gift. With respect to the latter period, the adjustments to the uniform basis are to be made in accordance with paragraph (e) of § 29.113 (a) (5)–1.

The time of the gift is the time when the gift is consummated. Delivery, actual or constructive, is requisite to a gift. In determining the time of the gift, the passing of title by the donor is not decisive; the time when the donor relinquishes substantial dominion over the property is decisive.

(c) *Fair market value.* For the purposes of this section, the value of property as appraised for the purpose of the Federal gift tax, or if the gift is not subject to such tax, its value as appraised for the purpose of a State gift tax, shall be deemed to be the fair market value of the property at the time of the gift.

(d) *Reinvestments by fiduciary.* If the property is an investment by the fiduciary under the terms of the gift (as, for example, in the case of a sale by the fiduciary of property transferred under the terms of the gift, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the basis specified in paragraph (b) of this section.

(e) *Records.* To insure a fair and adequate determination of the proper basis under section 113 (a) (2), persons making or receiving gifts of property should preserve and keep accessible a record of the facts necessary to determine the cost of the property and, if pertinent, its fair market value as if March 1, 1913.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(3) *Transfer in trust after December 31, 1920.* If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made.

§ 29.113 (a) (3)–1 *Transfer in trust after December 31, 1920*—(a) *Property included.* Section 113 (a) (3) applies in general to all property acquired after December 31, 1920, by transfer in trust. It does not apply to property acquired by bequest or devise, by an instrument which, under section 113 (a) (5), is to be treated as though it were a will, or to property acquired as a gift by transfer in trust made at any time after December 31, 1920. With these exceptions, section 113 (a) (3) applies to all property acquired after December 31, 1920, by any transfer in trust of whatever description. If the property was acquired as a gift by transfer in trust, it is not within section 113 (a) (3), but is within section 113 (a) (2) or section 113 (a) (4).

(b) *Basis.* The basis of property so acquired is the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by a transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether prior to the termination of the trust and distribution of the property, or thereafter.

(c) *Reimbursements by fiduciary.* If the property is an investment made by the fiduciary (as, for example, in the case of a sale by the fiduciary of property transferred by the grantor, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the basis specified in paragraph (b) of this section.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(4) *Gift or transfer in trust before January 1, 1921.* If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition.

§ 29.113 (a) (4)–1 *Gift or transfer in trust prior to January 1, 1921*—(a) *Property included.* Section 113 (a) (4) applies to all property acquired before January 1, 1921, by gift or transfer in trust. It does not apply to property acquired by a devise or bequest; or by an instrument which, under section 113 (a) (5), is to be treated as though it were a will.

(b) *Basis.* The basis is the fair market value of such property at the time of the gift or at the time of the transfer in trust. Such fair market value is to be ascertained in the manner prescribed in paragraph (c) of § 29.113 (a) (2)–1, or by equivalent methods.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(5) *Property transmitted at death.* If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. For the purpose of this paragraph property passing without full and adequate consideration under a general power of appointment exercised by will shall be deemed to be property passing from the individual exercising such power by bequest or devise. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, and if the decedent died after August 26, 1937, and if the property consists of stock or securities of a foreign corporation, which with respect to its taxable year next preceding the date of the decedent's death was, under the law applicable to such year, a foreign personal holding company, then the basis shall be the fair market value of such property at the time of such acquisition or the basis in the hands of the decedent, whichever is lower. In the case of an election made by the executor under section 811 (J), the time of acquisition of the property shall, for the purpose of this paragraph, be the applicable valuation date of the property prescribed by such section in determining the value of the gross estate. [Sec. 144 (b), Rev. Act 1942, provides that the last sentence of section 113 (a) (5) shall be applicable only with respect to the property includible in the gross estate of a decedent dying after October 21, 1942, the date of the enactment of the Revenue Act of 1942.]

§ 29.113 (a) (5)–1 *Basis of property acquired by bequest, devise, or inheritance*—(a) *Property included.* Section 113 (a) (5) applies:

(1) To all property passing from a decedent by his will or under the law governing the descent and distribution of property of decedents; and

(2) To property passing under an instrument which, under section 113 (a) (5), is treated as though it were a will, but applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

(b) *Basis.* Section 113 (a) (5) provides three rules for determining the basis of property transmitted at death, first, a rule governing property generally, second, a special rule governing stock in a foreign personal holding company, and, third, a special rule applicable to both the first and second rules in certain cases where for estate tax purposes the decedent's gross estate is valued at the optional valuation dates.

(1) *General rule.* Except as prescribed in subparagraphs (2) and (3) of this paragraph the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since, under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. For example, if distribution of personal property left by a decedent is not made until one year after his death, the basis of such property in the hands of the legatee is its fair market value at the time when the decedent died, and not when the legatee actually received the property; or, if the bequest is of the residue to trustees in trust, and the executors do not distribute the residue to such trustees until five years after the death of the decedent, the basis of each piece of property left by the decedent and thus received, in the hands of the trustees, is its fair market value at the time when the decedent dies; or, if the bequest is to trustees in trust to pay to A during

his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer as the sole survivor, the basis of such property, in the hands of the taxpayer, is its fair market value at the time when the decedent died.

The purpose of the Internal Revenue Code, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss.

(2) *Special rule with respect to stock in a foreign personal holding company.* In the case of decedents dying after August 26, 1937, the basis of stock of a foreign corporation acquired from the decedent by will or under the law governing descent and distribution of property of decedents, where such foreign corporation with respect to its taxable year next preceding the date of the decedent's death was a foreign personal holding company, is the fair market value of such stock at the time of such acquisition, i. e., the date of the decedent's death, or the basis in the hands of the decedent (with proper adjustments to the date of the decedent's death), whichever is lower.

(3) *Special rule where property valued at optional valuation dates.* Section 113 (a) (5) provides a special rule applicable in determining the basis of property described in subparagraphs (1) and (2) of this paragraph where:

(i) Such property is includible in the gross estate of a decedent who died after October 21, 1942, and

(ii) The executor elects for estate tax purposes under section 811 (j) to value the decedent's gross estate at the optional valuation dates prescribed in such section.

In such cases, the time of acquisition of such property for the purposes of subparagraphs (1) and (2) of this paragraph and the remainder of this section is considered to be the date at which such property is valued for estate tax purposes. Thus, in such cases, generally the basis will not be the value at the date of the decedent's death but (with certain limitations) the value at the date one year after his death or, in the case of such property distributed by the executor (or trustee, in certain cases) within one year after the decedent's death, the value as of the time of such distribution. See § 81.11 of this chapter.

(c) *Fair market value.* For the purposes of this section, the value of property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax or the optional value as appraised for such purpose, whichever is applicable as provided in paragraph (b) (3) of this section, or if the estate is not subject to such tax, its value appraised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be deemed to be its fair market value at the time of acquisition.

(d) *Property acquired before March 1, 1913; reinvestments by fiduciary.* If the decedent died before March 1, 1913, the fair market value on that date is taken in lieu of the fair market value on the date of death, but only to the same extent and for the same purposes as the fair market value on March 1, 1913, is taken under section 113 (a) (14).

If the property is an investment by the fiduciary under a will (as, for example, in the case of a sale by a fiduciary under a will of property transmitted from the decedent, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the fair market value at the time when the decedent died.

(e) *Adjustments to basis.* In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, or devise, or inheritance, the basis of the property is always the same,

(1) Whether such person be the executor or administrator, the heir, the legatee, the devisee, the trustee of a trust created by the will, or any beneficiary of such trust, and whatever the nature of any such person's interest or estate may be;

(2) Whether during or after administration and settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution by the executor or administrator, or the trustee.

Adjustments to basis required by section 113 (b) are made in accordance with the same principles. Thus, the deductions for depreciation and for depletion allowed or allowable, under section 23 (l) and section 23 (m), to a legal life tenant as if the life tenant were the absolute owner of the property, constitute an adjustment to the basis of the property in the hands not only of the life tenant, but also in the hands of the remainderman and every other person to whom the same uniform basis is applicable. Similarly, the deductions allowed or allowable under section 23 (l) and section 23 (m), both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property not only in the hands of the trustee, but also in the hands of the trust beneficiaries and every other person to whom the uniform basis is applicable. See, however, section 24 (a). Similarly, adjustments in respect of capital expenditures or losses, tax-free distributions, or other distributions applicable in reduction of basis, or other items for which the basis is adjustable are made without regard to which one of the persons to whom the same uniform basis is applicable makes the capital expenditures or sustains the capital losses, or to whom the tax-free or other distributions are made, or to whom the deductions are allowed or allowable.

The executor or other legal representative of the decedent, the fiduciary of a trust under a will, the life tenant and every other person to whom a uniform basis under this section is applicable, shall make and maintain records showing in detail all deductions, distributions, or other items for which adjustment to basis is required to be made by section 113 (b), and shall furnish to the Commissioner information with respect to such matters in such detail at such time and in such manner as the Commissioner may require.

(f) *Sales of remainder and other interests in property transmitted at death.* The following is an illustration of the rule stated in paragraph (b) of this section that, under section 113 (a) (5), the measure of gain or loss resulting from a sale or other disposition of property transmitted at death is the increase or decrease in the value of the property as reflected in such sale or other disposition: If land is left for life to A, with remainder in fee to B, and prior to A's death, B sells his remainder, the increase or decrease in the value of the land reflected, and realized by B, in the proceeds from the sale of his remainder interest constitutes the gain recognized upon the sale. (See section 111.) Such gain (or as the case may be, the loss) is computed by comparing the amount of the proceeds received from the sale with the amount of the part of the uniform basis assignable to such sale of B's remainder interest. The part of the uniform basis assignable to such a sale by B is the part of the uniform basis (adjusted to the time of the sale) of the land transmitted from the decedent which bears the same proportion to such uniform basis as B's remainder interest, at the time of the sale, bears to the whole estate in the land transmitted from the decedent.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(6) *Tax-free exchanges generally.* If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis (except as provided in paragraphs (15), (17), or (18) of this subsection) shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of

the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. Where as part of the consideration to the taxpayer another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for the purposes of this paragraph, be considered as money received by the taxpayer upon the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

§ 29.113 (a) (6)-1 *Property acquired upon a tax-free exchange.* In the case of an exchange, after February 28, 1913, of property solely of the type described in section 112 (b), if no part of the gain or loss was recognized under the law applicable to the year in which the exchange was made, the basis of the property acquired is the same as the basis of the property transferred by the taxpayer with proper adjustments to the date of the exchange.

If, in an exchange, after February 28, 1913, of properties of the type indicated in section 112 (b), gain to the taxpayer was recognized under the provisions of section 112 (c) or (d) or a similar provision of a prior Revenue Act, on account of the receipt of money in addition in the transaction, the basis of the property acquired is the basis of the property transferred (adjusted to the date of the exchange), decreased by the amount of money received and increased by the amount of gain recognized on the exchange. For example: A purchased a share of stock in the X Corporation in 1927 for $100. Pursuant to a plan of reorganization, A in 1942 exchanged his share for one share in the Y Corporation, worth $90, and $30 in cash. A realized a gain of $20 upon the exchange, all of which is recognized under section 112 (c) (1). As to the amount of such gain to be taken into account in computing net income, see section 117. The basis of the share of stock in the Y Corporation is $90; that is, the basis of the share in the X Corporation ($100) less the amount of money received by A ($30) plus the amount of gain recognized on the exchange ($20).

If, upon an exchange of properties of the type described in section 112(b), there was received by the taxpayer in addition other property (not permitted to be received without the recognition of gain) and money, and gain from the transaction was recognized as required under section 112 (c) or (d) or a similar provision of a prior Revenue Act, the basis (adjusted to the date of the exchange) of the property transferred by the taxpayer, decreased by the amount of money received and increased by the amount of gain recognized, must be apportioned to and is the basis of the properties (other than money) received on the exchange. For the purpose of the allocation of such basis to the properties received, there must be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

Example. A purchased a share of stock in the X Corporation in 1925 for $100. Upon a reorganization of the X Corporation in 1942, A received in place of his stock in the X Corporation a share of stock in the Y Corporation worth $60, a Treasury bond worth $50, and in addition $20 in cash. A realized a gain of $30 upon the exchange, all of which is recognized under section 112 (c) (1). As to the amount of such gain to be taken into account in computing net income, see section 117. The basis of the property received in exchange is the basis of the old stock ($100) decreased in the amount of money received ($20) and increased in the amount of gain that was recognized ($30), which results in a basis for the property received of $100. This basis of $110 is apportioned between the Treasury bond and the share of stock, the basis of the Treasury bond being its fair market value at the date of the exchange, $50, and of the share of stock, the remainder, $60.

Section 112 (e) and similar provisions of prior Revenue Acts provide that no loss may be recognized on an exchange of properties of a type described in section 112 (b), although the taxpayer receives other property or money from the transaction. However, the basis of the property or properties received by the taxpayer (other than money) is the basis (adjusted to the date of the exchange) of the property transferred, decreased by the amount of money received. This basis must be apportioned to the properties received, and for this purpose there must be allocated to such other property (not permitted to be exchanged tax free) an amount of such basis equivalent to the fair market value of such other property at the date of the exchange.

Section 113 (a) (6) does not apply in ascertaining the basis of property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it. But see section 113 (a) (7) and (8).

§ 29.113 (a) (6)-2 *Treatment of assumption of liabilities.* For the purposes of section 113 (a) (6) the amount of any liabilities of the taxpayer assumed by the other party to the exchange is to be treated as money received by the taxpayer upon the exchange, whether or not the assumption of liabilities resulted in a recognition of gain or loss to the taxpayer under the law applicable to the year in which the exchange was made.

The application of this section may be illustrated by the following examples:

Example (1). A, an individual, owns property having an adjusted basis of $100,000 and on which there is a purchase money mortgage of $25,000. On September 1, 1942, A organizes the X Corporation to which he transfers the property above described in exchange for all the capital stock of the X Corporation and the assumption of the $25,000 mortgage. The capital stock of the X Corporation has a fair market value of $150,000. Under section 112 (b) (5), no gain is recognized. The basis of such stock in A's hands is $75,000, computed as follows:

Adjusted basis of property transferred	$100,000
Less: Amount of money received (amount of liabilities assumed by X Corporation)	25,000
Basis of stock of the X Corporation in A's hands	75,000

Example (2). B, an individual, owns an apartment house which has an adjusted basis in his hands of $500,000, but which is subject to a mortgage of $150,000. On September 1, 1942, he transfers such apartment house to C, receiving in exchange therefor $50,000 in cash and another apartment house with a fair market value on that date of $600,000. The transfer to C is made subject to the $150,000 mortgage, but C does not assume such mortgage. B realizes a gain of $300,000 on the exchange, computed as follows:

Value of property received	$600,000
Cash	50,000
Liabilities subject to which old property was transferred	150,000
Total consideration received	800,000
Less: Adjusted basis of property transferred	500,000
Gain realized	300,000

Since section 112 (k) does not apply to section 112 (b) (1) or so much of section 112 (c) as relates to section 112 (b) (1), $200,000 of such $300,000 gain is recognized. The basis of the apartment house acquired by B upon the exchange is $500,000, computed as follows:

Adjusted basis of property transferred		$500,000
Less: Amount of money received:		
Cash	$50,000	
Amount of liabilities subject to which property was transferred	150,000	
		200,000
Difference		$300,000
Plus: Amount of gain recognized upon the exchange		200,000
Basis of property acquired upon the exchange		500,000

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(7) *Transfers to corporation.* If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

§ 29.113 (a) (7)–1 *Property acquired by corporation in reorganization after December 31, 1917.* Section 113 (a) (7) sets forth the conditions under which the basis of property acquired by a corporation after December 31, 1917, in connection with a reorganization as defined in section 112 is the same as it would be in the hands of the transferor, increased or decreased as therein provided in the amount of gain or loss recognized to the transferor under the applicable revenue law. In the case of property so acquired in a taxable year beginning prior to January 1, 1936, such basis is applicable only if immediately after the transfer there remained in the same persons or any of them an interest or control in such property of 50 percent or more. In the case, however, of property so acquired in a taxable year beginning after December 31, 1935, section 113 (a) (7) is applicable irrespective of the extent of the interest or amount of control in such property remaining, immediately after the transfer, in the hands of the same persons or any of them.

The application of the provisions of section 113 (a) (7) (A) may be illustrated by the following examples:

Example (1). In 1925 the X Corporation caused the organization of the Y Corporation and transferred to the Y Corporation, in exchange for all the capital stock of that corporation, property which it had previously purchased for $10,000. The basis of the property in the hands of the Y Corporation is $10,000.

Example (2). In 1925 the M Corporation exchanged 10 percent of its voting stock for all the property of the N Corporation which had a basis of $10,000 in the hands of the N Corporation. The basis of the property in the hands of the M Corporation is cost thereof to it at the time of the transfer, that is, the fair market value of the M stock exchanged for the property.

Section 113 (a) (7) does not apply if, irrespective of when acquired, the property consists of stock or securities in a corporation a party to a reorganization as defined in section 112, unless such stock or securities are acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer. The application of the last sentence of section 113 (a) (7) to a case where such stock or securities are acquired by the issuance of stock or securities of the transferee may be illustrated as follows:

Example (3). The Y Corporation owns all of the stock of the X Corporation, which stock it acquired in 1942 by the issuance of all of its own voting stock to the individual shareholders of the X Corporation. The stock of the X Corporation was acquired by the individuals in 1924 for $200,000 in cash. The stock of the Y Corporation had a fair market value of $1,000,000 at the time it was exchanged in 1942 for the stock of the X Corporation. The fair market value of the stock of the X Corporation at the time of the exchange in 1942 was also $1,000,000. The basis to the Y Corporation of the stock of the X Corporation is the basis which such stock would have had in the hands of the individuals from which it was acquired by the Y Corporation, that is, $200,000.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(8) *Property acquired by issuance of stock or as paid-in surplus.* If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

§ 29.113 (a) (8)–1 *Property acquired by a corporation after December 31, 1920.* The acquisition of property by a corporation after December 31, 1917, by the issuance of its stock or securities may not fall within the provisions of section 113 (a) (7), because of the fact that the property was not acquired in connection with a reorganization. If, however, the acquisition of such property occurred after December 31, 1920, and falls within the provisions of section 113 (a) (8), the limitations therein imposed upon the basis of such property are applicable.

In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, or from any person as a contribution to capital, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift, the basis thereof shall be determined under section 113 (a) (2).

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(9) *Involuntary conversion.* If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in section 112 (f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

§ 29.113 (a) (9)–1 *Property acquired as a result of an involuntary conversion.* The provisions of section 113 (a) (9) may be illustrated by the following example:

Example. A vessel purchased by A in 1927 for $100,000 is destroyed in 1942 and A receives insurance in the amount of $200,000. Disregarding, for the purpose of this example, the adjustment for depreciation, if A invests $150,000 in a new vessel, taxable gain to the extent of $50,000 would be recognized. The basis of the new vessel is $100,000; that is, the cost of the old vessel ($100,000) minus the money received by the taxpayer which was not expended in the acquisition of the new vessel ($50,000) plus the amount of gain recognized upon the conversion ($50,000). If any amount in excess of the proceeds of the conversion is expended in the acquisition of the new property, such amount may be added to the basis otherwise determined.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(10) *Wash sales of stock.* If the property consists of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this chapter or corresponding provisions of prior income tax laws, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, then the basis shall be the basis of the stock or securities so sold or disposed of, increased or decreased, as the case may be, by the difference, if any, between the price at which the property was acquired and the price at which such substantially identical stock or securities were sold or otherwise disposed of.

§ 29.113 (a) (10)–1 *Stocks or securities acquired in "wash sales."* The application of section 113 (a) (10) may be illustrated by the following examples:

Example (1). A purchased a share of common stock of the X Corporation for $100 in 1927, which he sold January 15, 1942, for $80. On February 1, 1942, he purchased a share of common stock of the same corporation for $90. No loss from the sale is recognized under section 118. The basis of the new share is $110; that is, the basis of the old share ($100) increased by $10, the excess of the price at which the new share was acquired ($90) over the price at which the old share was sold ($80).

Example (2). A purchased a share of common stock of the Y Corporation for $100 in 1927, which he sold January 15, 1942, for $80. On February 1, 1942, he purchased a share of common stock of the same corporation for $70. No loss from the sale is recognized under section 118. The basis of the new share is $90; that is, the basis of the old share ($100) decreased by $10, the excess of the price at which the old share was sold ($80) over the price at which the new share was acquired ($70).

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(11) *Property acquired during affiliation.* In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to inter-company transactions in respect of which gain or loss was not recog-

nized. For the purposes of this paragraph, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928. The basis in case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this chapter or the Revenue Act of 1928, 45 Stat. 831, or the Revenue Act of 1932, 47 Stat. 213, or the Revenue Act of 1934, 48 Stat. 720, or the Revenue Act of 1936, 49 Stat. 1698, or the Revenue Act of 1938, 52 Stat. 508, shall be determined in accordance with regulations prescribed under section 141 (b) of this chapter or the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936 or the Revenue Act of 1938. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this chapter or the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936 or the Revenue Act of 1938, shall be adjusted in respect of any items relating to such period, in accordance with regulations prescribed under section 141 (b) of this chapter or the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936 or the Revenue Act of 1938, applicable to such period.

§ 29.113 (a) (11)–1 *Basis of property acquired during affiliation.* The basis of property acquired by a corporation during a period of affiliation from a corporation with which it was affiliated shall be the same as it would be in the hands of the corporation from which acquired. This rule is applicable if the basis of the property is material in determining tax liability for any year, whether a separate return or a consolidated return is made in respect of such year. For the purpose of this section, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto), but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928.

Example. The X Corporation, the Y Corporation, and the Z Corporation were affiliated for the taxable year 1920. During that year the X Corporation transferred assets to the Y Corporation for $120,000 cash, and the Y Corporation in turn transferred the assets during the same year to the Z Corporation for $130,000 cash. The assets were acquired by the X Corporation in 1916 at a cost of $100,000. The basis of the assets in the hands of the Z Corporation is $100,000.

The basis of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return was made or was required under Regulations 75, Regulations 78, Regulations 89, Part 4, Part 15 or Part 23 of this chapter, or subsequent regulations relating to consolidated returns, shall be determined in accordance with such regulations. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made or is required under Regulations 75, Regulations 78, Regulations 89, Part 4, Part 15 or Part 23 of this chapter, or subsequent regulations relating to consolidated returns, shall be adjusted in respect of any items relating to such period in accordance with such regulations.

The basis of property after a consolidated return period shall be the same as immediately prior to the close of such period. For example, if a corporation has been a member of an affiliated group which has made a consolidated return on the calendar year basis for the taxable year 1941 and makes a separate return for the taxable year 1942 and succeeding taxable years, the value of the opening inventory to be used in computing such corporation's net income for the taxable year 1942 is the proper value of the closing inventory used in computing the consolidated net income for the preceding taxable year.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939: sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(12) *Basis established by Revenue Act of 1932.* If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932, 47 Stat. 199, was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this chapter the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

§ 29.113 (a) (12)–1 *Basis of property established by Revenue Act of 1932.* Section 113 (a) (1) provides that if the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis of the property, for the purposes of the Revenue Act of 1932, was prescribed by section 113 (a) (6), (7), or (9) of that Act, then for the purposes of the Internal Revenue Code the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

If, after December 31, 1923, and in any taxable year beginning prior to January 1, 1934, in pursuance of a plan of reorganization and without the surrender of his stock, there was distributed to a shareholder in a corporation a party to the reorganization stock or securities of a corporation a party to the reorganization, then as is provided in section 113 (a) (9) of the Revenue Act of 1932, the basis of the stock in respect of which the distribution was made must be apportioned between such stock and the stock or securities so distributed to the shareholder. The basis of the old shares and the new shares or securties shall be determined in accordance with the following rules:

(a) If the stock distributed in reorganization consists solely of stock in the distributing corporation and is all of substantially the same character and preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and the new shares.

(b) If the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or if the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security to which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provisions, securities are different in class from stocks and stocks or securities in one corporation are different in class from stocks or securities in another corporation. In general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

(c) If the stock in respect of which a distribution in reorganization is made was purchased at different times or at different prices, and the identity of the lots cannot be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see § 29.22 (a)–8), and any sale of the stock or securities distributed in reorganization will be resumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

(d) If the stock in respect of which a distribution in reorganization is made was purchased at different times or at different prices, and the stock or securities distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock or securities distributed in reorganization will be presumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

If in any taxable year beginning after December 31, 1941, without the surrender of his stock there is acquired by a shareholder in a corporation a party to a reorganization, as a distribution in pursuance of the plan of reorganization, stock or securities in a corporation a party to the reorganization, such acquisition of new shares or securities by the shareholder will be treated as a dividend to the extent described in § 29.112 (g)–5.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941;

secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that]—

(13) *Partnerships.* If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any other paragraph of this subsection, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

§ 29.113 (a) (13)–1 *Property contributed in kind by a partner to a partnership.* The basis of property contributed in kind by a partner to partnership capital after February 28, 1913, is the cost or other basis thereof to the contributing partner. Annual allowances to the partnership for depletion and depreciation are to be computed on such basis. If such basis is greater than the fair market value of the property at the date of the transfer to the partnership, the annual depletion or depreciation allowances shall be allocated to and included in the determination of the distributive shares of the partners in accordance with their agreement in respect of the sharing of gains or losses affecting partnership capital. If the basis of such contributed property is less than the fair market value thereof at the date of transfer to the partnership, the annual allowances for depletion and depreciation are to be limited to such basis and may be apportioned among the partners according to their agreement with respect to the sharing of gains or losses affecting partnership capital. On the sale or other disposition of such contributed property by the partnership the gain or loss, determined on such transferred basis, adjusted as required by section 113 (b), shall be prorated in determining the distributive shares of the partners according to their gain or loss ratios on the disposition of a partnership asset under the partnership agreement.

§ 29.113 (a) (13)–2 *Readjustment of partnership interests.* When a partner retires from a partnership, or the partnership is dissolved, the partner realizes a gain or loss measured by the difference between the price received for his interest and the sum of the adjusted cost or other basis to him of his interest in the partnership plus the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. However, if such interest in the partnership was acquired prior to March 1, 1913, both the cost or other basis as hereinbefore provided and the value of such interest as of such date, plus the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid, shall be ascertained, and the gain derived or the loss sustained shall be computed as provided in § 29.111–1. See also section 117. If the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received in liquidation. The basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

If a new partner is admitted to the partnership, or an existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain has been realized or loss sustained by any partner.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(14) *Property acquired before March 1, 1913.* In the case of property acquired before March 1, 1913, if the basis otherwise determined under this subsection, adjusted (for the period prior to March 1, 1913) as provided in subsection (b), is less than the fair market value of the property as of March 1, 1913, then the basis for determining gain shall be such fair market value. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

§ 29.113 (a) (14)–1 *Property acquired prior to March 1, 1913.* The basis as of March 1, 1913, for determining gain in the case of property acquired prior to that date, is the basis otherwise provided for such property under section 113 (a), adjusted for the period prior to March 1, 1913, or the fair market value of the property as of March 1, 1913, whichever is higher.

The basis as of March 1, 1913, for determining loss in the case of property acquired prior to that date is the cost or other basis provided for such property under section 113 (a) adjusted as required by section 113 (b), but without reference to the fair market value of the property as of March 1, 1913.

Example. A, who makes his returns upon the calendar year basis, in 1908 purchased property for $100,000. Assuming, for the purposes of this example, that there are no additions and betterments to be taken into account, the depreciation sustained on the property prior to March 1, 1913, was $10,000, so that the original cost adjusted as of March 1, 1913, for depreciation sustained prior to that date was $90,000. As of that date the fair market value of the property was $94,000. (*a*) For the purpose of determining gain from the sale or other disposition of the property on March 1, 1942, the basis of the property is the fair market value of $94,000 as of March 1, 1913, adjusted for depreciation for the period subsequent to February 28, 1913, computed on such fair market value. If it be assumed that the amount of depreciation deductions allowed (not less than the amount allowable) after February 28, 1913, to the year 1942 is in the aggregate sum of $43,240, the adjusted basis for determining gain in 1942 ($94,000 less $43,240) is $50,760. (*b*) For the purpose of determining a loss from the sale or other disposition of such property in 1942, the basis of the property is the cost of the property, without reference to the fair market value as of March 1, 1913, adjusted for depreciation before March 1, 1913, and after February 28, 1913. The amount of depreciation sustained prior to March 1, 1913, in this example is $10,000, and if the amount of depreciation to be accounted for after February 28, 1913, is assumed to be $43,240, the aggregate amount of depreciation for which adjustment of such cost must be made is $53,240. The adjusted basis for determining the loss in 1942 ($100,000 less $53,240) is $46,760.

What the fair market value of property was on March 1, 1913, is a question of fact to be established by competent evidence. In determining the fair market value of stock in a corporation, due regard shall be given to the fair market value of the corporate assets on such date. In the case of property traded in on public exchanges, actual sales at or about the basic date afford evidence of value. In general, the fair market value of a block or aggregate of a particular kind of property is not to be determined by a forced sale price or by an estimate of what a whole block or aggregate would bring if placed upon the market at one and the same time, but such value should be determined by ascertaining as the basis the fair market value of each unit of the property. All relevant facts and elements of value as of the basic date should be considered in every case.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(15) *Property received by a corporation on complete liquidation of another.* If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of section 112 (b) (6), then the basis shall be the same as it would be in the hands of the transferor. The basis of property with respect to which election has been made in pursuance of the last sentence of section 113 (a) (15) of the Revenue Act of 1936, as amended, shall, in the hands of the corporation making such election, be the basis prescribed in the Revenue Act of 1934, as amended.

§ 29.113 (a) (15)–1 *Basis of property received by a corporation in complete liquidation of another corporation.* Except as otherwise provided in this section, the basis of property received in complete liquidation, without the recognition of gain or loss as provided in section 112 (b) (6), shall be the same as the basis of the property in the hands of the liquidating corporation with proper adjustments as provided in section 113. See section 113 (b).

In the case of property received in liquidation after December 31, 1935, and before June 23, 1936, in a taxable year of the recipient corporation beginning after December 31, 1935, the basis of such property in the hands of the recipient corporation shall be the basis prescribed by section 113 (a) (6) of the Revenue Act of 1934, as amended by the Revenue Act of 1935, if:

(a) Such property was received in a liquidation which was completed before June 23, 1936;

(b) Such liquidation constituted a complete liquidation within the meaning of section 112 (b) (6) of the Revenue Act of 1934, as added by the Revenue Act of 1935;

(c) No gain or loss would have been recognized under section 112 (b) (6) of the Revenue Act of 1934, as amended, upon the receipt of such property; and

(d) The recipient corporation (within 180 days after the enactment of the Revenue Act of 1938) under regulations prescribed under section 808 of the Revenue Act of 1938, (Treasury Decision 4815)[1] elected to have such basis apply to such property.

If such an election was made, the basis of such property received in liquidation shall be the cost or other basis (adjusted as provided in section 113) of the stock of the liquidating corporation surrendered in exchange for the property, decreased in the amount of money received and increased in the amount of gain or decreased in the amount of loss to the recipient corporation that was recognized upon the liquidation under the Revenue Act of 1936. If such property consists of more than one class of property the basis shall be allocated among the several properties (other than money) received, in the proportion that the fair market value of each such property as of the date of distribution bears to the fair market value of all such properties on that date.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(16) *Basis established by revenue act of 1934.* If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1936, and the basis thereof, for the purposes of the Revenue Act of 1934 was prescribed by section 113 (a) (6), (7), or (8) of such Act, then for the purposes of this chapter the basis shall be the same as the basis therein prescribed in the Revenue Act of 1934.

§ 29.113 (a) (16)–1 *Basis of property established by Revenue Act of 1934.* Section 113 (a) (16) provides that if property was acquired after February 28, 1913, in any taxable year begining prior to January 1, 1936, and the basis of the property for the purposes of the Revenue Act of 1934 was prescribed by section 113 (a) (6), (7), or (8) of that Act, then for the purposes of the Internal Revenue Code the basis shall be the same as the basis therein prescribed under the Revenue Act of 1934. For example, if after December 31, 1920, and in any taxable year beginning prior to January 1, 1936, property was acquired by a corporation by the issuance of its stock or securities in connection with a transaction which is not described in section 112 (b) (5) of the Code but which is described in section 112 (b) (5) of the Revenue Act of 1934, the basis of the property so acquired shall be the same as it would be in the hands of the transferor, with proper adjustments to the date of the exchange.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(17) *Property acquired in connection with exchanges and distributions in obedience to certain orders of the Securities and Exchange Commission.* If the property was acquired in a taxable year beginning before January 1, 1942, in any manner described in section 372 prior to its amendment by the Revenue Act of 1942, the basis shall be that prescribed in such section (prior to its amendment by such Act) with respect to such property. If the property was acquired in a taxable year beginning after December 31, 1941, in any manner described in section 372 (other than subsection (a) (2) after its amendment by such Act, the basis shall be that prescribed in such section (after its amendment by such Act) with respect to such property.

(18) *Property received in certain corporate liquidations.* If the property was acquired by a shareholder in the liquidation of a corporation in cancellation or redemption of stock with respect to which gain was realized, but with respect to which, as the result of an election made by him under paragraph (7) of section 112 (b), of the Revenue Act of 1938, 52 Stat. 487, the extent to which gain was recognized was determined under such paragraph, then the basis shall be the same as the basis of such stock cancelled or redeemed in the liquidation, decreased in the amount of any money received by him, and increased in the amount of gain recognized to him.

§ 29.113 (a) (18)–1 *Basis of property received in certain corporate liquidations*—(a) *Property included.* Section 113 (a) (18) applies only to property (other than money) acquired (1) by a qualified electing shareholder, (2) upon a distribution in complete liquidation of a domestic corporation pursuant to a plan of liquidation adopted after May 28, 1938, in accordance with which the distribution is in complete cancellation or redemption of all the stock and the transfer of all the property in the liquidation occurs within the month of December 1938, and (3) in cancellation or redemption of only those shares of stock which were owned by such qualified electing shareholder on the date of the adoption of the plan of liquidation and on which he realizes gain. It applies to all the property, except money, so acquired, though such property may consist in whole or in part of stock or securities acquired by the liquidating corporation after April 9, 1938.

(b) *Basis.* The basis of such property so acquired is the same as the basis of the shares of stock, in cancellation or redemption of which such property was received, with proper adjustments to the date of acquisition, decreased in the amount of such shares' ratable share of any money received in cancellation or redemption of shares of the same class, and increased in the amount of gain recognized under the provisions of section 112 (b) (7) of the Revenue Act of 1938. If such property consists of more than one class of property, the basis shall be allocated among the several properties (other than money) acquired in the proportion that the fair market value of each such property as of the date of acquisition bears to the fair market value of all such properties on that date. The application of this subsection may be illustrated by the following example:

Example. The X Corporation distributed all its property in complete liquidation during the month of December 1938, pursuant to the provisions of section 112 (b) (7) of the Revenue Act of 1938. A, an individual and a qualified electing shareholder, received, in cancellation or redemption of 100 shares of stock owned by him on the date of the adoption of the plan of liquidation, $1,000 in cash, property (other than stock or securities acquired by the corporation after April 9, 1938) with a fair market value of $12,000, and stock acquired by the liquidating corporation after April 9, 1938, with a fair market value of $4,000. The basis of the shares owned by A was $100 per share, or $10,000. A's ratable share of the earnings and profits of the X Corporation accumulated after February 28, 1913 (computed as provided in section 112 (b) (7) of the Revenue Act of 1938), was $2,500. His gain is $7,000, but under section 112 (b) (7) of the Revenue Act of 1938 only $5,000 of this gain is recognized, $2,500 thereof being taxed as a dividend. The basis of all the property other than money received by A is $14,000, computed as follows:

Adjusted basis of stock canceled or redeemed	$10,000
Less money received	1,000
Remainder	9,000
Plus gain recognized	5,000
Basis of property acquired	14,000

This basis will be apportioned among the classes of property (other than money) received as follows: 12,000/16,000 of $14,000, or $10,500, to the property other than stock; 4,000/16,000 of $14,000, or $3,500, to the stock.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(19) (A) If the property was acquired by a shareholder in a corporation and consists of stock in such corporation, or rights to acquire such stock, acquired by him after February 28, 1913, in a distribution by such corporation (hereinafter in this paragraph called "new stock"), or consists of stock in respect of which such distribution was made (hereinafter in this paragraph called "old stock") and

(i) the new stock was acquired in a taxable year beginning before January 1, 1936; or

(ii) the new stock was acquired in a taxable year beginning after December 31, 1935, and its distribution did not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution:

then the basis of the new stock and of the old stock, respectively, shall, in the shareholder's hands, be determined by allocating between the old stock and the new stock the adjusted basis of the old stock; such allocation to be made under regulations which shall be prescribed by the Commissioner with the approval of the Secretary.

[1] 26 CFR 3.113 (a) (15)–1.

(B) Where the new stock consisted of rights to acquire stock and such rights were sold in a taxable year beginning before January 1, 1939, and there was included in the gross income for such year the entire amount of the proceeds of such sale, then, if before the date of the enactment of the Revenue Act of 1939 the taxpayer has not asserted (by claim for a refund or credit or otherwise) that any part of the proceeds of the sale of such new stock should be excluded from gross income for the year of its sale, the basis of the old stock shall be determined without regard to subparagraph (A); and no part of the proceeds of the sale of such new stock shall ever be excluded from the gross income of the year of such sale.

(C) Subparagraph (A) shall not apply if the new stock was acquired in a taxable year beginning before January 1, 1936, and there was included, as a dividend, in gross income for such year an amount on account of such stock, and after such inclusion such amount was not (before the date of the enactment of the Revenue Act of 1939) excluded from gross income for such year.

(D) Subparagraph (A) shall not apply if the new stock or the old stock was sold or otherwise disposed of in a taxable year beginning prior to January 1, 1936, and the basis (determined by a decision of a court or the Board of Tax Appeals [known as The Tax Court of the United States], or a closing agreement, and the decision or agreement became final before the ninetieth day after the date of the enactment of the Revenue Act of 1939) for determining gain or loss on such sale or other disposition was ascertained by a method other than that of allocation of the basis of the old stock.

§ 29.113 (a) (19)–1 *Basis of stock and rights involved in the acquisition of stock dividends or stock rights; general rules*—(a) *Stock dividends.* In the case of stock in respect of which was acquired a stock dividend of any character in a taxable year beginning before January 1, 1936, or in respect of which was acquired in a taxable year beginning after December 31, 1935, a stock dividend which did not constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution, the basis for determining gain or loss from a sale or other disposition of either the stock in respect of which the distribution was made or the stock dividend shall (except as otherwise prescribed in § 29.113 (a) (19)–2) be ascertained in accordance with the principles set forth in § 29.113 (a) (12)–1.

(b) *Stock rights acquired after December 31, 1924.* In the case of stock in respect of which were acquired after December 31, 1924, and before the first day of the first taxable year beginning after December 31, 1935, stock subscription rights (whether or not constituting income to the shareholder within the meaning of the sixteenth amendment to the Constitution) or in respect of which were acquired in a taxable year beginning after December 31, 1935, stock subscription rights which did not constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution, and in the case of such rights, the basis for determining gain or loss from a sale or other disposition of either the stock in respect of which the distribution was made, or the subscription rights distributed, or the stock acquired in the exercise of such rights shall (except as otherwise prescribed in § 29.113 (a) (19)–2) be ascertained in accordance with the principles set forth in § 29.22 (a)–8.

(c) *Stock rights acquired before January 1, 1925.* In the case of stock in respect of which were acquired prior to January 1, 1925, stock subscription rights (whether or not constituting income to the shareholder within the meaning of the sixteenth amendment to the Constitution), and in the case of such rights, the basis for determining gain or loss from a sale or other disposition of either the stock in respect of which the distribution was made, or the subscription rights distributed, or the stock acquired in the exercise of such rights shall (except as otherwise prescribed in § 29.113 (a) (19)–2) be ascertained in accordance with the principles set forth in article 39 of Regulations 65.

§ 29.113 (a) (19)–2 *Exceptions to general rules*—(a) *Proceeds of sale of rights reported as income.* In the case of stock rights sold in a taxable year beginning prior to January 1, 1939, the general rules for ascertaining the basis for determining gain or loss set forth in paragraphs (b) and (c) of § 29.113 (a) (19)–1, and in § 29.22 (a)–8 or article 39 of Regulations 65, as the case may be, shall not apply if the entire proceeds of such sale were included by the taxpayer as gross income for the year of the sale and if, before June 29, 1939, the taxpayer had not asserted by a claim for a refund or credit or otherwise that any part of such proceeds should not have been included in gross income for the year of the sale. In such cases, the basis for determining gain or loss from a subsequent sale or other disposition of the stock in respect of which the rights were acquired shall be the same as though the rights had not been acquired.

(b) *Receipt of stock dividend or stock right reported as income in prior years.* In the case of stock dividends or stock rights acquired in a taxable year beginning prior to January 1, 1936, the general rules for ascertaining the basis for determining gain or loss set forth in § 29.113 (a) (19)–1, and in §§ 29.113 (a) (12)–1, 29.22 (a)–8, or article 39 of Regulations 65, as the case may be, shall not apply if for any reason there was included in the gross income of the shareholder as a dividend for such year, as, for example, pursuant to the provisions of section 201 (c) of the Revenue Act of 1918 or the corresponding provisions of prior Revenue Acts, or as a result of the decision of the Supreme Court in Koshland *v.* Helvering (298 U. S. 441), an amount reflecting the acquisition of such stock dividend or stock rights, and if before June 29, 1939, such amount was not excluded from gross income for such year. In such cases, the basis for determining gain or loss with respect to the old stock shall be the same as though the stock dividends or the stock rights had not been acquired, and the basis with respect to the stock dividend or stock right shall be an amount equal to that at which such stock dividend or stock right was included in gross income for the year of its acquisition.

(c) *Gain or loss upon sale of old or new stock finally determined upon basis inconsistent with general rules.* The general rules for ascertaining the basis for determining gain or loss set forth in § 29.113 (a) (19)–1 shall not apply with respect to the old stock, the new stock, or the subscription rights to acquire new stock, remaining on hand after a sale or other disposition of old stock, subscription rights, or new stock effected in a taxable year beginning prior to January 1, 1936, if the basis for determining gain or loss on such sale or other disposition was fixed by a decision of a court or The Tax Court of the United States or by a closing agreement, and if such decision or closing agreement became final on or before September 26, 1939, and if the basis for determining gain or loss upon such sale or other disposition was fixed by a method other than that of allocation of basis provided by the general rule. In such cases, the basis for determining gain or loss with respect to the remaining shares shall be fixed in a manner consistent with the prior determination to the end that, the sale or other disposition of all lots being considered, the taxpayer will have effected ultimately a tax-free recovery of the total cost or other basis of his original shares, and no more.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act, 1939; sec. 1, Pub Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(20) *Property acquired by railroad corporation.* If the property of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, was acquired after December 31, 1939, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77 of the National Bankruptcy Act, as amended,

and the acquiring corporation is a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, organized or made use of to effectuate a plan or[1] reorganization approved by the court in such proceeding, the basis shall be the same as it would be in the hands of the railroad corporation whose property was so acquired. The term "reorganization," as used in this paragraph, shall not be limited by the definition of such term in section 112 (g).

§ 29.113 (a) (20)–1 *Property acquired by railroad corporation in a receivership or bankruptcy proceeding.* Section 113 (a) (20) sets forth certain conditions under which the basis of property acquired by a railroad corporation is the same as it would have been in the hands of the railroad corporation whose property was acquired. For the purpose of section 113 (a) (20), it is unnecessary that the acquisition in question be a direct transfer from the corporation undergoing reorganization or that such reorganization constitute a reorganization within the meaning of section 112 (g). It is sufficient if the acquisition is in pursuance of an order of the court and is an integral step in the consummation of a reorganization plan approved by the

[1] Evidently intended to be "of".

court having jurisdiction of the proceeding.

If the conditions of section 113 (a) (20) are satisfied, then for the purpose of determining basis, the provisions of section 113 (a) (20) only shall apply, notwithstanding that the transaction might also fall within another provision of section 113 (a).

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(a) *Basis (unadjusted) of property.* The basis of property shall be the cost of such property; except that—]

(21) *Property acquired by street, suburban, or interurban electric railway corporation.* If the property of any street, suburban, or interurban electric railway corporation engaged as a common carrier in the transportation of persons or property in interstate commerce was acquired after December 31, 1934, in pursuance of an order of the court having jurisdiction of such corporation in a proceeding under section 77B of the National Bankruptcy Act, as amended, and the acquiring corporation is a street, suburban, or interurban electric railway engaged as a common carrier in the transportation of persons or property in interstate commerce, organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, then, notwithstanding the provisions of section 270 of Chapter X of the National Bankruptcy Act, as amended, the basis, for any taxable year beginning after December 31, 1939, shall be the same as it would be in the hands of the corporation whose property was so acquired. The term "reorganization", as used in this paragraph, shall not be limited by the definition of such term in section 112 (g).

§ 29.113 (a) (21)–1 *Property acquired by electric railway corporation in bankruptcy proceeding.* Subject to the limitations and conditions set forth in section 113 (a) (21), if the reorganization under section 77B of the National Bankruptcy Act, as amended, of an electric railway corporation results in the acquisition of the property of such corporation by another corporate entity, the basis of such property in the hands of the acquiring corporation is the same as it would be in the hands of the old corporation. It is requisite to the application of the section that both corporations be street, suburban, or interurban electric railway corporations engaged in the transportation of persons or property in interstate commerce, and that the acquisition is in pursuance of an order of the court and is an integral step in the consummation of a reorganization plan approved by the court having jurisdiction of the proceeding. If section 113 (a) (21) applies, section 270 of Chapter X of the National Bankruptcy Act, as amended, relating to the adjustment of basis by reason of the cancellation or reduction of indebtedness in a bankruptcy proceeding, is inapplicable. Moreover, if the transaction is within the provisions of section 113 (a) (21) and may also be considered to be within any other provision of section 113 (a), then the provisions of section 113 (a) (21) only shall apply.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

(b) *Adjusted basis.* The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.* Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

(C) in respect of any period prior to March 1, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent sustained;

(D) in the case of stock (to the extent not provided for in the foregoing subparagraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918, Feb. 24, 1919, c. 18, 40 Stat. 1057, or the Revenue Act of 1921, Nov. 23, 1921, c. 136, 42 Stat. 227, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921);

(E) to the extent provided in section 337 (f) in the case of the stock of United States shareholders in a foreign personal holding company; and

(F) to the extent provided in section 28 (h) in the case of amounts specified in a shareholder's consent made under section 28.

(G) in the case of property pledged to the Commodity Credit Corporation, to the extent of the amount received as a loan from the Commodity Credit Corporation and treated by the taxpayer as income for the year in which received pursuant to section 123 of this chapter, and to the extent of any deficiency on such loan with respect to which the taxpayer has been relieved from liability.

(H) in the case of any bond (as defined in section 125) the interest on which is wholly exempt from the tax imposed by this chapter, to the extent of the amortizable bond premium disallowable as a deduction pursuant to section 125 (a) (2), and in the case of any other bond (as defined in such section) to the extent of the deductions allowable pursuant to section 125 (a) (1) with respect thereto.

§ 29.113 (b) (1)–1 *Adjusted basis; general rule.* The adjusted basis for determining the gain or loss from the sale or other disposition of property is the cost of such property or, in the case of such property as is described in section 113 (a) (1) to (21), inclusive, the basis therein provided, adjusted to the extent provided in section 113 (b).

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. In the case of mines and oil or gas wells the following shall not be considered as items properly chargeable to capital account: (1) Expenditures made in the taxable year 1932 or subsequent taxable years which are allowable under article 235 or 236 of Regulations 77, article 23 (m)–15 or 23 (m)–16 of Regulations 86, article 23 (m)–15 or 23 (m)–16 of Regulations 94,[1] article 23 (m)–15 or 23 (m)–16 of Regulations 101,[1] §§ 19.23 (m)–15 or 19.23 (m)–16 of Regulations 103, and §§ 29.23 (m)–15 or 29.23 (m)–16 of these regulations as deductions in computing net income; (2) expenditures made in taxable years prior to 1932 which were allowed, or which may hereafter be allowed, as deductions in computing the net income of the taxpayer for such taxable years.

Example. A, who makes his returns on the calendar year basis, purchased property in 1933 for $10,000. He subsequently expended $6,000 for improvements. Disregarding, for the purpose of this example, the adjustments required for depreciation, the adjusted basis of the property is $16,000. If A sells the property in 1942 for $20,000, the amount of his gain will be $4,000. As to the amount of such gain to be taken into account in computing net income, see section 117.

Capital expenditures and carrying charges with respect to property, whether real or personal, improved or unimproved and whether productive or unproductive, such as taxes and interest, as to which under these regulations there is an election to treat either as chargeable to capital account or as an allowable deduction in the manner provided in § 29.24–5 (c) but for which there have been taken no deductions by the taxpayer in determining net income for the taxable year, or a prior taxable year, are properly chargeable to capital account. (See § 29.24–5.) The term "taxes" for this purpose includes duties and excise taxes (see § 29.23 (c)–2), but does not include income taxes.

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolence, amortization, and depletion to the extent such deductions have in respect to any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under chapter 1 or prior income tax laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. The determination of the amount properly allowable shall, however, be made

[1] §§ 3.23 (m)–15, 3.23 (m)–16, 9.23 (m)–15, 9.23 (m)–16 of this chapter.

on the basis of facts reasonably known to exist at the end of such year or period. The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted. For example, the case of Corporation A discloses the following facts as of January 1, 1942:

Year	Allowed	Allowable	Allowed, but not less than amount allowable
1935	$6,000	$5,000	$6,000
1936	7,000	6,500	7,000
1937	6,500	6,500	6,500
1938	6,500	6,000	6,500
1939	5,000	6,000	6,000
1940	4,500	6,000	6,000
1941	4,000	6,000	6,000
	39,500	42,000	44,000

The depreciation allowed but not less than the amount allowable in this example as of January 1, 1942, is $44,000, and the cost or other basis of the property is to be adjusted by that amount. The deductions by which the cost or other basis is to be decreased shall include deductions allowed under section 114 (b) (2), (3), and (4) of the Revenue Act of 1932, the Revenue Act of 1934, the Revenue Act of 1936, the Revenue Act of 1938, and the Internal Revenue Code, for the taxable year 1932 and subsequent taxable years, but the amount of the diminution in respect of depletion for taxable years prior to 1932 shall not exceed a depletion deduction computed without reference to discovery value in the case of mines, or without reference to discovery value or a percentage of income in the case of oil and gas wells.

The cost or other basis shall also be decreased by the exhaustion, wear and tear, obsolescence, amortization, and depletion sustained in respect of any period prior to March 1, 1913.

In the case of stock, the cost or other basis must be diminished by the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921).

Example. A, who makes his returns upon the calendar year basis, purchased stock in 1923 for $5,000. He received in 1924 a distribution of $2,000 paid out of earnings and profits of the corporation accumulated prior to March 1, 1913. The adjusted basis for determining the gain or loss from the sale or other disposition of the stock in 1942 is $5,000 less $2,000, or $3,000, and the amount of the gain or loss from the sale or other disposition of the stock is the difference between $3,000 and the amount realized from the sale or other disposition. But see section 117.

In the case of the stock of United States shareholders in a foreign personal holding company the cost or other basis must be adjusted also to the extent provided in section 337 (f).

Adjustments must always be made to eliminate double deductions or their equivalent. Thus, in the case of the stock of a subsidiary company, the basis thereof must be properly adjusted for the amount of the subsidiary company's losses for the years in which consolidated returns were made.

In determining basis, and adjustments to basis, the principles of estoppel apply, as elsewhere under the Internal Revenue Code. For adjustment to basis of bonds on account of amortizable bond premium, see §§ 29.125–1 to 29.125–9, inclusive.

§ 29.113 (b) (1)–2 *Adjusted basis; cancellation of indebtedness.* In addition to the adjustments provided in section 113 (b) (1) and § 29.113 (b) (1)–1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any proceeding under sections 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B or under Chapter X, XI, or XII of the Bankruptcy Act of 1898, as amended. Such further adjustment shall be made in the following manner and order:

(a) In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable) whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, which indebtedness shall have been canceled or reduced in any such proceeding, the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness so incurred with respect to such property shall have been canceled or reduced;

(b) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the cancellation or reduction of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness secured by such lien shall have been canceled or reduced;

(c) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced in such proceeding over the sum of the adjustments made under (a) and (b) shall next be applied to reduce the cost or other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by (a) and (b) as follows: The cost or other basis of each unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis (after adjustment under (a) and (b)) of each such unit of property bears to the sum of the adjusted bases (after adjustment under (a) and (b)) of all the property of the debtor other than inventory and notes and accounts receivable;

(d) Any excess of the total amount by which such indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (a), (b), and (c) shall next be applied to reduce the cost or other basis of any units of property covered by (a), (b), and (c) which have a remaining basis (after adjustment under (a), (b), and (c)) greater than their fair market value, as follows: The cost or other basis of each such unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the remaining basis of each such unit bears to the sum of the remaining bases of such units. The process shall be repeated until the cost or other basis of each unit of the property covered by (a), (b), and (c) is reduced to its fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value; and

(e) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (a), (b), (c), and (d) shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows: The cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable. The process shall be repeated until the adjusted bases of inventory, notes receivable and accounts receivable are reduced to their fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value.

For the purposes of this section:

(1) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(2) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(3) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return;

(4) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor,

as purchaser of such property, has assumed to pay; and

(5) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this section.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this section.

§ 29.113 (b) (1)–3 *Adjusted basis; cancellation of indebtedness; special cases.* If the taxpayer and the Commissioner agree, the basis of the taxpayer's property may be adjusted in a manner different from that set forth in § 29.113 (b) (1)–2. Variations from such rule may, for example, involve adjusting the basis of any part of the taxpayer's property or adjusting the basis of all the taxpayer's property, according to a fixed allocation. Agreement between the taxpayer and the Commissioner as to any variation from such general rule shall be effected only by a closing agreement entered into under the provisions of section 3760.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(b) *Adjusted basis.* The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.]

(2) *Substituted basis.* The term "substituted basis" as used in this subsection means a basis determined under any provision of subsection (a) of this section or under any corresponding provision of a prior income tax law, providing that the basis shall be determined—

(A) by reference to the basis in the hands of a transferor, donor, or grantor, or

(B) by reference to other property held at any time by the person for whom the basis is to be determined.

Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, then the adjustments provided in paragraph (1) of this subsection shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases.

§ 29.113 (b) (2)–1 *Substituted basis.* Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, as defined in section 113 (b) (2), the adjustments indicated in § 29.113 (b) (1)–1 shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. In addition, whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, as defined in section 113 (b) (2) (A), the adjustments indicated in §§ 29.113 (b) (1)–2, 29.113 (b) (3)–1, and 29.113 (b) (3)–2 shall also be made, whenever necessary, after first making in respect of such substituted basis a proper adjustment of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor. Similar rules shall also be applied in the case of a series of substituted bases.

Example. A, who makes his returns upon the calendar year basis, in 1927 purchased the X Building and subsequently gave it to his son B. B exchanged the X Building for the Y Building in a tax-free exchange, and then gave the Y Building to his wife C. C, in determining the gain from the sale or other disposition of the Y Building in 1942, is required to reduce the basis of the building by deductions for depreciation which were successively allowed (but not less than the amount allowable) to A and B upon the X Building and to B upon the Y Building, in addition to the deductions for depreciation allowed (but not less than the amount allowable) to herself during her ownership of the Y Building.

[SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 233 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

[(b) *Adjusted basis.* The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.]

(3) *Discharge of indebtedness.* Where in the case of a corporation any amount is excluded from gross income under section 22 (b) (9) on account of the discharge of indebtedness the whole or a part of the amount so excluded from gross income shall be applied in reduction of the basis of any property held (whether before or after the time of the discharge) by the taxpayer during any portion of the taxable year in which such discharge occurred. The amount to be so applied (not in excess of the amount so excluded from gross income, reduced by the amount of any deduction disallowed under section 22 (b) (9)) and the particular properties to which the reduction shall be allocated, shall be determined under regulations (prescribed by the Commissioner with the approval of the Secretary) in effect at the time of the filing of the consent by the taxpayer referred to in section 22 (b) (9). The reduction shall be made as of the first day of the taxable year in which the discharge occurred except in the case of property not held by the taxpayer on such first day, in which case it shall take effect as of the time the holding of the taxpayer began.

§ 29.113 (b) (3)–1 *Adjusted basis; discharge of corporate indebtedness; general rule.* In addition to the adjustments provided in section 113 (b) (1) and § 29.113 (b) (1)–1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been an exclusion from gross income under section 22 (b) (9) on account of the discharge of indebtedness of a corporation during the taxable year. Such further adjustment shall, except as otherwise provided in § 29.113 (b) (3)–2, be made in the following manner and order:

(a) In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable), whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, which indebtedness shall have been discharged, the cost or other basis of such property shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this section) by an amount equal to the amount excluded from gross income under section 22 (b) (9) and attributable to the discharge of the indebtedness so incurred with respect to such property;

(b) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the discharge of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) the cost or other basis of such property shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this section) by an amount equal to the amount excluded from gross income under section 22 (b) (9) and attributable to the discharge of the indebtedness secured by such lien;

(c) Any excess of the total amount excluded from gross income under section 22 (b) (9) over the sum of the adjustments made under (a) and (b) shall next be applied to reduce the cost or other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by (a) and (b)) as follows: The cost or other basis of each unit of property shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this section) in an amount equal to such proportion of such excess as the adjusted basis (without reference to this section) of each such unit of property bears to the sum of adjusted bases (without reference to this section) of all the property of the debtor other than inventory and notes and accounts receivable; and

(d) Any excess of the total amount excluded from gross income under section 22 (b) (9) over the sum of the adjustments made under (a), (b), and (c) shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows: The cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this section) in an amount equal to such proportion of such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of

the adjusted bases of such inventory and notes and accounts receivable.

For the purposes of this section:

(1) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(2) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay;

(3) The phrase "amount excluded from gross income under section 22 (b) (9)" means the amount of income excluded under that section reduced by any deduction disallowed under that section for unamortized discount;

(4) Adjustments to basis shall be made:

(i) In the case of property owned on the first day of the taxable year, as of that day;

(ii) In the case of property acquired after the first day of the taxable year, as of the day so acquired;

regardless of the time such property was subsequently sold, exchanged, or otherwise disposed of by the taxpayer;

(5) Whenever a discharge of indebtedness is accomplished by a transfer of the taxpayer's property in kind, the difference between the amount of the obligation discharged and the fair market value of the property transferred is the amount which may be applied in reduction of basis;

(6) Regardless of the amount excluded by the taxpayer from its gross income under section 22 (b) (9) and so stated on Form 982, the maximum amount by which basis may be reduced in respect of the discharge of any indebtedness is the amount of income resulting from the discharge of such indebtedness.

Example (1). On January 1, 1942, the N Corporation owned an office building, which it sold in March 1942. In June 1942 it purchased a factory building. In October 1942 the N Corporation bought in its outstanding bonds at less than their face value. Assuming that there is a proper exclusion from gross income under section 22 (b) (9), the basis of each building shall be adjusted under section 113 (b) (3) for the taxable year 1942. (But see § 29.113 (b) (3)-2.)

Example (2). The M Corporation has outstanding an issue of A bonds which it had sold at a premium and an issue of B bonds which it had sold at a discount. In July 1942 the M Corporation purchased such outstanding bonds for less than face value. The amount of income attributable to the discharge of the A bonds is $1,000 and the amount of unamortized premium is $200. The amount of income attributable to the discharge of the B bonds is $1,000 and the amount of unamortized discount is $50.

If the M Corporation under section 22 (b) (9) elects to have excluded from gross income the amount of income attributable to the discharge of both bond issues, the total reduction in basis of the property of the M Corporation shall not exceed $2,150. If the M Corporation elects only with respect to the A bonds, the total reduction in basis shall not exceed $1,200 (or $950 if the election is with respect to the A bonds, the total poration excludes only an amount of $500 with respect to the A bonds, the total reduction in basis may nevertheless be $1,200 (or $950 if the exclusion is with respect to the B bonds).

§ 29.113 (b) (3)-2 *Adjusted basis; discharge of corporate indebtedness; special cases.* Section 29.113 (b) (3)-1 prescribes the general rule to be followed in adjusting basis of property where there is a proper exclusion from gross income under section 22 (b) (9). The taxpayer may, however, have the basis of its property adjusted in a manner different from that set forth in § 29.113 (b) (3)-1 upon a proper showing to the satisfaction of the Commissioner. Variations from such general rule may, for example, involve adjusting the basis of only part of the taxpayer's property or adjusting the basis of all the taxpayer's property, according to a fixed allocation.

A request for variations from the general rule prescribed in § 29.113 (b) (3)-1 should be filed by the taxpayer with its return for the taxable year in which the discharge of indebtedness has occurred. Agreement between the taxpayer and the Commissioner as to any variations from such general rule shall be effected only by a closing agreement entered into under the provisions of section 3760. If no agreement is reached between the taxpayer and the Commissioner as to variations from the general rule prescribed in § 29.113 (b) (3)-1, then the consent filed on Form 982 shall be deemed to be a consent to the application of such general rule and such general rule shall prevail in the determination of the basis of the taxpayer's property, unless the taxpayer specifically states on such form that it does not consent to the application of the general rule.

[SEC. 113 ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—as amended by secs. 213 (d), 214 (a), 215 (b), 223 (b), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; secs. 115 (b), 126 (c), 130 (b), 142 (b) (c), 143 (a) (b), 144 (a), 171 (h), Rev. Act 1942.]

(c) *Property on which lessee has made improvements.* Neither the basis nor the adjusted basis of any portion of real property shall, in the case of the lessor of such property, be increased or diminished on account of income derived by the lessor in respect of such property and excludible from gross income under section 22 (b) (11). If an amount representing any part of the value of real property attributable to buildings erected or other improvements made by a lessee in respect of such property was included in gross income of the lessor for any taxable year beginning before January 1, 1942, the basis of each portion of such property shall be properly adjusted for the amount so included in gross income.

§ 29.113 (c)-1 *Property on which lessee has made improvements.* In any case in which a lessee of real property has erected buildings or made other improvements upon the leased property and the lease is terminated by forfeiture or otherwise resulting in the realization by such lessor of income which, were it not for the provisions of section 22 (b) (11), would be includible in gross income of the lessor, the amount so excluded from gross income shall not be taken into account in determining the basis or the adjusted basis of such property or any portion thereof in the hands of the lessor. If, however, in any taxable year beginning prior to January 1, 1942, there has been included in the gross income of the lessor an amount representing any part of the value of such property attributable to such buildings or improvements, the basis of each portion of such property shall be properly adjusted for the amount so included in gross income. For example, A leased in 1930 from B for a period of 25 years unimproved real property and in accordance with the terms of the lease B erected a building on the property. It was estimated that upon expiration of the lease the building would have a depreciated value of $50,000, which value the lessor elected to report (beginning in 1931) as income over the term of the lease. In 1942 B forfeits the lease. The amount of $22,000 reported as income by A during the years 1931 to 1941, both years inclusive, shall be added to the basis of the property represented by the improvements in the hands of A. If in such case A did not report during the period of the lease any income attributable to the value of the building erected by the lessee and the lease was forfeited in 1940 when the building was worth $75,000, such amount, having been included in gross income under the law applicable to that year, is added to the basis of the property represented by the improvements in the hands of A. As to treatment of such property for the purposes of capital gains and losses, see section 117.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION [as amended by sec. 145, Rev. Act 1942].

(a) *Basis for depreciation.* The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) *Basis for depletion*—(1) *General rule.* The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

(2) *Discovery value in case of mines.* In the case of mines (other than metal, coal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mines) discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance under section 23 (m) based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit.

(3) *Percentage depletion for oil and gas wells.* In the case of oil and gas wells the allowance for depletion under section 23 (m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

(4) *Percentage depletion for coal, fluorspar, ball and sagger clay, rock asphalt, and metal mines and sulphur.* The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, fluorspar, ball and sagger clay or rock asphalt mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

§ 29.114–1 *Basis for allowance of depreciation and depletion.* The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain from the sale or other disposition of such property, except as provided in § 29.23 (m)–3, relating to depletion based on discovery value, in § 29.23 (m)–4, relating to percentage depletion in the case of oil and gas wells, and in § 29.23 (m)–5, relating to percentage depletion in the case of coal mines, metal mines, fluorspar mines, ball and sagger clay mines, or rock asphalt mines, and sulphur mines or deposits.

SEC. 115. DISTRIBUTIONS BY CORPORATIONS [as amended by sec. 214 (b), Rev. Act 1939; sec. 501 (a), 2d Rev. Act, 1940; secs. 146 (a), 147, 166, 186 (a) (b), Rev. Act 1942].

(a) *Definition of dividend.* The term "dividend" when used in this chapter (except in section 201 (c) (5), section 204 (c) (11), and section 207 (a) (2) and (b) (3) (where the reference is to dividends of insurance companies paid to policyholders) means any distribution made by a corporation to its shareholders, whether in money or in other property (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. Such term also means any distribution to its shareholders, whether in money or in other property, made by a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company, or which, for the taxable year in respect of which the distribution is made under section 504 (c) or section 506 or a corresponding provision of a prior income tax law, is a personal holding company under the law applicable to such taxable year.

(b) *Source of distributions.* For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113. The preceding sentence shall not apply to a distribution which is a dividend within the meaning of the last sentence of subsection (a).

(c) *Distributions in liquidation.* Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. If any distribution in partial liquidation or in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) is made by a foreign corporation which with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding company, and with respect to which a United States group (as defined in section 331 (a) (2)) existed after August 26, 1937, and before January 1, 1938, then, despite the foregoing provisions of this subsection, the gain recognized resulting from such distribution shall be considered as a gain from the sale or exchange of a capital asset held for not more than 6 months.

(d) *Other distributions from capital.* If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. This subsection shall not apply to a distribution in partial or complete liquidation or to a distribution which, under subsection (f) (1), is not treated as a dividend, whether or not otherwise a dividend.

(e) *Distributions by personal service corporations.* Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918, 40 Stat. 1070, or section 218 of the Revenue Act of 1921, 42 Stat. 245, shall be exempt from tax to the distributees.

(f) *Stock dividends*—(1) *General rule.* A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of shareholders as to medium of payment.* Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

(g) *Redemption of stock.* If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redempton or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) *Effect on earnings and profits of distributions of stock.* The distribution (whether before January 1, 1939, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) If no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) If the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934, 48 Stat. 712, or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of partial liquidation.* As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

(j) *Valuation of dividend.* If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

(k) *Consent distributions.* For taxability as dividends of amounts agreed to be included in gross income by shareholders' consents, see section 28.

(l) *Effect on earnings and profits of gain or loss and of receipt of tax-free distributions.* The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

(1) for the purpose of the computation of earnings and profits of the corporation, shall be determined, except as provided in paragraph (2), by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(2) for the purpose of the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law ap-

plicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. Where in determining the adjusted basis used in computing such realized gain or loss the adjustment to the basis differs from the adjustment proper for the purposes of determining earnings or profits, then the latter adjustment shall be used in determining the increase or decrease above provided. For the purpose of this subsection, a loss with respect to which a deduction is disallowed under section 118, or a corresponding provision of a prior income-tax law, shall not be deemed to be recognized. Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

(1) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made.

(2) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received.

(m) *Earnings and profits—increase in value accrued before March 1, 1913.* (1) If any increase or decrease in the earnings or profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2), an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase, in value of property accrued before March 1, 1913.

(2) If the application of subsection (l) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (l) and in lieu of the rule provided in paragraph (1) of this subsection, the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

§ 29.115–1 *Dividends.* The term "dividend" for the purpose of chapter 1 (except when used in section 201 (c) (5), section 204 (c) (11), and section 207 (a) (2) and (b) (3) where the reference is to dividends of insurance companies paid to policyholders) comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either:

(a) Earnings or profits accumulated since February 28, 1913, or

(b) Earnings or profits of the taxable year computed without regard to the amount of the earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

The term "dividend" also includes any distribution to shareholders (other than distributions under section 115 (c), relating to distributions in liquidation, section 115 (e), relating to distributions by personal service corporations, and section 115 (f), relating to stock dividends) made by a corporation which, for the taxable year in which such a distribution is made or for the taxable year in respect of which it is made under section 504 (c), relating to dividends paid within 2½ months after the close of the taxable year, or section 506, relating to deficiency dividends, or corresponding provisions of a prior income tax law, was under the applicable law a personal holding company. Such a distribution, if made on or after October 21, 1942, will constitute a taxable dividend even if not paid out of accumulated or current earnings or profits. For treatment of any distribution made prior to October 21, 1942, which is a dividend solely by reason of the last sentence of section 115 (a), see § 29.504–3.

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands.

The application of section 115 (a) may be illustrated by the following example:

Example. At the beginning of the calendar year 1942, the M Corporation had an operating deficit of $200,000 and the earnings or profits for the year amounted to $100,000. Beginning on March 16, 1942, the corporation made quarterly distributions during the taxable year to its shareholders of $25,000 each. Each distribution is a taxable dividend in full, irrespective of the actual or the pro rata amount of the earnings or profits on hand at any of the dates of distribution, since the total distributions made during the year ($100,000) did not exceed the total earnings or profits of the year ($100,000).

§ 29.115–2 *Sources of distributions in general.* For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits. In determining the source of a distribution, consideration should be given first, to the earnings or profits of the taxable year; second, to the earnings or profits accumulated since February 28, 1913, only in the case where, and to the extent that, the distributions made during the taxable year are not regarded as out of the earnings or profits of that year; third, to the earnings or profits accumulated prior to March 1, 1913, only after all the earnings or profits of the taxable year and all the earnings or profits accumulated since February 28, 1913, have been distributed; and, fourth, to sources other than earnings or profits only after the earnings or profits have been distributed.

If the earnings or profits of the taxable year (computed as of the close of the year without diminution by reason of any distributions made during the year and without regard to the amount of earnings or profits at the time of the distribution) are sufficient in amount to cover all the distributions made during that year, then each distribution is a taxable dividend. (See § 29.115–1.) If the distributions made during the taxable year exceed the earnings or profits of such year, then that proportion of each distribution which the total of the earnings or profits of the year bears to the total distributions made during the year shall be regarded as out of the earnings or profits of that year. The portion of each such distribution which is not regarded as out of earnings or profits of the taxable year shall be considered a taxable dividend to the extent of the earnings or profits accumulated since February 28, 1913, and available on the date of the distribution. In any case in which it is necessary to determine the amount of earnings or profits accumulated since February 28, 1913, and the actual earnings or profits to the date of a distribution within any taxable year (whether beginning before January 1, 1936, or, in the case of an operating deficit, on or after that date) cannot be shown, the earnings and profits for the year (or accounting period, if less than a year) in which the distribution was made shall be prorated to the date of the distribution not counting the date on which the distribution was made. The provisions of this section may be illustrated by the following example:

Example. At the beginning of the calendar year 1942, the M Corporation had $12,000 in earnings and profits accumulated since February 28, 1913. Its earnings and profits for 1942 amounted to $30,000. During the year it made quarterly distributions of $15,000 each. Of each of the four distributions made, $7,500 (that portion of $15,000 which the amount of $30,000, the total earnings and profits of the taxable year, bears to $60,000, the total distributions made during the year) was paid out of the earnings and profits of the taxable year; and of the first and second distributions, $7,500 and $4,500, respectively, were paid out of the earnings and profits accumulated after February 28, 1913, and prior to the taxable year, as follows:

Distributions during 1942		Portion out of earnings or profits of the taxable year	Portion out of earnings accumulated since Feb. 28, 1913, and prior to taxable year	Taxable amount of each distribution
Date	Amount			
Mar. 10	$15,000	$7,500	$7,500	$15,000
June 10	15,000	7,500	4,500	12,000
Sept. 10	15,000	7,500	----------	7,500
Dec. 10	15,000	7,500	----------	7,500
Total amount taxable as dividends				42,000

Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether prior to or on or after March 1, 1913), is not a dividend within the meaning of chapter 1.

§ 29.115–3 *Earnings or profits.* In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be conclusive, the amount of the earnings or profits in any case will be dependent upon the method of accounting properly employed in computing net income. For instance, a corporation keeping its books and filing its income tax returns under sections 41, 42, and 43 on the cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation computing income on the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis; and an insurance company subject to taxation under section 204 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 204 (b) (5) and which is segregated accordingly in the unearned premium reserve.

Among the items entering into the computation of corporate earnings or profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22 (a) or corresponding provisions of prior Revenue Acts. Gains and losses within the purview of section 112 or corresponding provisions of prior Revenue Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section (see § 29.115–12). Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

In the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on cost or other basis without regard to March 1, 1913, value. In computing the earnings and profits for any period beginning after February 28, 1913, the only depletion or depreciation deductions to be considered are those based on (1) cost or other basis, if the depletable or depreciable asset was acquired subsequent to February 28, 1913, or (2) adjusted cost of March 1, 1913, value, whichever is higher, if acquired prior to March 1, 1913. Thus, discovery or percentage depletion under all Revenue Acts for mines and oil and gas wells is not to be taken into consideration in computing the earnings and profits of a corporation. Similarly, where the basis of property in the hands of a corporation is a substituted basis, such basis, and not the fair market value of the property at the time of the acquisition by the corporation, is the basis for computing depletion and depreciation for the purpose of determining earnings and profits of the corporation. The provisions of this paragraph may be illustrated by the following example:

Example. Oil producing property which A had acquired in 1936 at a cost of $28,000 was transferred to the Y Corporation in December 1938, in exchange for all of its capital stock. The fair market value of the stock and of the property as of the date of the transfer was $247,000. The Y Corporation, after four years' operations, effected in 1942 a cash distribution to A in the amount of $165,000. In determining the extent to which the earnings and profits of the Y Corporation available for dividend distributions have been increased as the result of production and sale of oil, the depletion to be taken into account is to be computed upon the basis of $28,000 established in the nontaxable exchange in 1938 regardless of the fair market value of the property or of the stock issued in exchange therefor.

A loss sustained for a year prior to the taxable year does not affect the earnings or profits of the taxable year. However, in determining the earnings or profits accumulated since February 28, 1913, the excess of a loss sustained for a year subsequent to February 28, 1913, over the undistributed earnings or profits accumulated since February 28, 1913, and prior to the year for which the loss was sustained, reduces surplus as of March 1, 1913, to the extent of such excess. And, if the surplus as of March 1, 1913, was sufficient to absorb such excess, distributions to shareholders after the year of the loss are out of earnings or profits accumulated since the year of the loss to the extent of such earnings.

With respect to the effect on the earnings or profits accumulated since February 28, 1913, of distributions made on or after January 1, 1916, and prior to August 6, 1917, out of earnings or profits accumulated prior to March 1, 1913, which distributions were specifically declared to be out of earnings or profits accumulated prior to March 1, 1913, see section 31 (b) of the Revenue Act of 1916, as amended by section 1211 of the Revenue Act of 1917.

§ 29.115–4 *Distributions other than a dividend.* Under section 115 (d), any distribution (including a distribution out of earnings or profits accumulated before March 1, 1913) other than:

(a) A dividend (see §§ 29.115–1 and 29.115–2),

(b) A distribution out of increase in value of property accrued prior to March 1, 1913 (see § 29.111–1),

(c) A distribution in partial or complete liquidation (see § 29.115–5), or

(d) A distribution which, under section 115 (f) (1), is not treated as a dividend (see § 29.115–7)

shall be applied against and reduce the adjusted basis of the stock provided in section 113 and shall be taxable to the recipient if, and to the extent that, such distribution exceeds such basis. The provisions of this section are applicable to such distributions received by one corporation from another corporation.

Example. In 1942 the M Corporation purchased certain shares of stock in the O Corporation for $10,000. During that year the M Corporation received a distribution from the O Corporation of $2,000 paid out of earnings or profits of the O Corporation accumulated prior to March 1, 1913. This distribution must be applied by the M. Corporation against the basis of its stock in the O Corporation reducing such basis to $8,000. The $2,000 does not constitute a part of the earnings or profits of the M Corporation. If the M Corporation subsequently sells the stock of the O Corporation for $9,000, it realizes a gain of $1,000, which constitutes a part of its earnings or profits for the year in which the stock is sold. If the distribution had amounted to $14,000, the gain of $4,000 would be taxable to the M Corporation and would have constituted a part of the earnings or profits of that corporation for the year in which the distribution was made.

§ 29.115–5 *Distributions in liquidation.* Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and § 29.111–1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112, and shall be subject to the conditions and limitations provided in section 117.

The term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not prorata among the shareholders.

In the case of amounts distributed in partial liquidation, the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining taxability of subsequent distributions by the corporation. (See §§ 29.27 (g)–1 and 29.115–11.)

For the purposes of the last sentence of section 115 (c), a liquidation may be completed prior to the actual dissolution of the liquidating corporation but no liquidation is completed until the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible).

For the purposes of this section the determination of whether a foreign cor-

poration was a foreign personal holding company with respect to a taxable year beginning on or before, and ending after August 26, 1937, shall be made under section 331 of the Revenue Act of 1936 and the regulations thereunder.

The provisions of this section may be illustrated by the following examples:

Example (1). A, an individual who makes his income tax returns on the calendar year basis, owns 20 shares of stock of the P Corporation, a domestic corporation, 10 shares of which were acquired in 1931 at a cost of $1,500, and the remainder of 10 shares in December 1941 at a cost of $2,900. He receives in April 1942 a distribution of $250 per share in complete liquidation, or $2,500 on the 10 shares acquired in 1931, and $2,500 on the 10 shares acquired in December 1941. The gain of $1,000 on the shares acquired in 1931 should be included in A's gross income to the extent of 50 percent, or $500; the loss of $400 on the shares acquired in 1941 should be deducted in computing A's net income to the extent of 100 percent, or $400. (See section 117.)

Example (2). A, an individual who makes his income tax returns on the calendar year basis, owned 20 shares of participating preferred stock of the Z Corporation, 10 shares of which were acquired in 1933 for $1,700 and 10 shares of which were acquired in January 1942 for $1,120. In May 1942 the corporation in a transaction qualifying as a partial liquidation redeemed the entire issue of preferred stock by paying the holders thereof $152 per share. A received $1,520 on the 10 shares acquired in 1933, and $1,520 on the 10 shares acquired in January 1942. The loss of $180 on the shares acquired in 1933 should be deducted in computing A's net income to the extent of 100 percent, or $400. the gain of $400 on the shares acquired in January 1942 should be included in A's gross income to the extent of 100 percent, or $400. (See section 117.)

§ 29.115–6 *Distributions from depletion or depreciation reserves.* A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost or other basis of the property will not be considered as having been paid out of earnings or profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock upon which declared. If such a distribution is in excess of the basis, the excess shall be taxed as a gain from the sale or other disposition of property as provided in § 29.111–1. A distribution from a depletion reserve based upon discovery value to the extent that such reserve represents the excess of the discovery value over the cost or other basis for determining gain or loss, is, when received by the shareholders, taxable as an ordinary dividend. The amount by which a corporation's percentage depletion allowance for any year exceeds depletion sustained on cost or other basis, that is, determined without regard to discovery or percentage depletion allowances for the year of distribution of prior years, constitutes a part of the corporation's "earnings or profits accumulated after February 28, 1913," within the meaning of section 115, and, upon distribution to shareholders, is taxable to them as a dividend. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings or profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared. (See § 29.111–1.) No distribution, however, can be made from such a reserve until all the earnings or profits of the corporation have first been distributed.

§ 29.115–7 *Stock dividends.* A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution. A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock which would not otherwise be treated as a dividend shall not be so treated merely because such distribution was made out of treasury stock or consisted of rights to acquire treasury stock.

§ 29.115–8 *Election of shareholders as to medium of payment.* If the shareholder has the right to an election or option with respect to whether a distribution shall be paid either (a) in money or any other property or (b) in stock or rights to acquire stock of a class which, if distributed without an election, would not constitute income within the meaning of the sixteenth amendment to the Constitution, then the entire distribution is a taxable dividend regardless of:

(1) Whether the distribution is actually made, in whole or in part, in stock or in stock rights which, if distributed without election, would not constitute a taxable dividend;

(2) Whether the election is exercised or exercisable before or after the declaration of the distribution; or

(3) Whether the declaration of the dividend provides that payment will be made in one medium unless the shareholder specifically requests payment in the other.

The term "any other property" as used in this section includes stock of the corporation or rights to acquire its stock, of a class which if distributed without an election, would constitute income within the meaning of the sixteenth amendment to the Constitution. (See § 29.115–7.)

§ 29.115–9 *Distribution in redemption or cancellation of stock taxable as a dividend.* If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. If a distribution is made pursuant to a corporate resolution reciting that the distribution is made in liquidation of the corporation, and the corporation is completely liquidated and dissolved within one year after the distribution, the distribution will not be considered essentially equivalent to the distribution of a taxable dividend; in all other cases the facts and circumstances should be reported to the Commissioner for his determination whether the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend.

§ 29.115–10 *Dividends paid in property.* If the whole or any part of the dividend is paid to a shareholder in any medium other than money, the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder. (See § 29.42–3.) Scrip dividends are subject to tax in the year in which the warrants are issued.

§ 29.115–11 *Effect on earnings or profits of certain tax-free exchanges and tax-free distributions.* If, under the law applicable to the year in which any transfer or exchange of property after February 28, 1913, was made (including transfers in connection with a reorganization or a complete liquidation under section 112 (b) (6) and intercompany transfers of property during a period of affiliation), gain or loss was not recognized (or was recognized only to the extent of the property received other than that permitted by such law to be received without the recognition of gain), then proper adjustment and allocation of the earnings or profits of the transferor shall be made as between the transferor and transferee corporations.

The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:

(a) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the re-

organization, to its shareholders of stock or securities in such corporation or in another corporation a party to the reorganization:

(1) In any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1932); or

(2) In any taxable year (beginning before January 1, 1939, or on or after such date) in exchange for its stock or securities (see section 112 (b) (3))

if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(b) The distribution in any taxable year (beginning before January 1, 1939, or on or after such date) of stock or securities, or other property or money, to a corporation in complete liquidation of another corporation, under the circumstances described in section 112 (b) (6) of the Revenue Act of 1936, or of the Revenue Act of 1938, or of the Internal Revenue Code.

(c) The distribution in any taxable year (beginning after December 31, 1938) of stock or securities, or other property or money, in the case of an exchange or distribution described in section 371 (relating to exchanges and distributions in obedience to orders of the Securities and Exchange Commission), if no gain to the distributees from the receipt of such stock, securities, or other property or money was recognized by law.

(d) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

A distribution described in paragraph (a), (b), (c), or (d) above does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. In the case, however, of amounts distributed in liquidation (other than a tax-free liquidation or reorganization described in paragraph (a), (b), or (c) above) the earnings or profits of the corporation making the distribution are diminished by the portion of such distribution properly chargeable to earnings or profits accumulated after February 28, 1913, after first deducting from the amount of such distribution the portion thereof allocable to capital account.

For the purposes of this section, the terms "reorganization" and "party to the reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932; for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934; for any taxable year beginning after December 31, 1935, and before January 1, 1938, have the meanings assigned to such terms in section 112 of the Revenue Act of 1936; and for any taxable year beginning after December 31, 1937, and before January 1, 1939, have the meanings assigned to such terms in section 112 of the Revenue Act of 1938.

§ 29.115–12 *Effect on earnings and profits of gain or loss realized after February 28, 1913.* In order to determine the effect on earnings and profits of gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation, section 115 (l) prescribed certain rules for (1) the computation of the total earnings and profits of the corporation, of most frequent application in determining invested capital; and (2) the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, of most frequent application in determining the source of dividend distributions. Such rules are applicable whenever under any provision of chapter 1 or 2 it is necessary to compute either the total earnings and profits of the corporation or the earnings and profits for any period beginning after February 28, 1913. For example, since the earnings and profits accumulated after February 28, 1913, or the earnings and profits of the taxable year, are earnings and profits for a period beginning after February 28, 1913, the determination of either must be in accordance with the rules herein prescribed for the ascertainment of earnings and profits for any period beginning after February 28, 1913. Under (1) such gain or loss is determined by using the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, but disregarding value as of March 1, 1913. Under (2) there is used such adjusted basis for determining gain, giving effect to the value as of March 1, 1913, whenever applicable. In both cases the rules are the same as those governing depreciation and depletion in computing earnings and profits (see § 29.115–3). Under both (1) and (2) the adjusted basis is subject to the limitations of the third sentence of section 115 (l) requiring the use of adjustments proper in determining earnings and profits. The proper adjustments may differ under (1) and (2) of section 115 (l) depending upon the basis to which the adjustments are to be made. If the application of (2) of the first sentence of section 115 (l) results in a loss and if the application of (1) of such sentence to the same transaction reaches a different result, then the loss under (2) will be subject to the adjustment thereto required by section 115 (m) (2). (See § 29.115–14.)

The gain or loss so realized increases or decreases the earnings and profits to, but not beyond, the extend to which such gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. As used in this paragraph the term "recognized" has reference to that kind of realized gain or loss which is recognized for income tax purposes by the statute applicable to the year in which the gain or loss was realized, for example, see section 112. A loss (other than a wash sale loss with respect to which a deduction is disallowed under the provisions of section 118 or corresponding provisions of prior revenue laws) may be recognized though not allowed as a deduction (by reason, for example, of the operation of sections 24 (b) and 117 and corresponding provisions of prior revenue laws) but the mere fact that it is not allowed does not prevent decrease in earnings and profits by the amount of such disallowed loss. Wash sale losses, however, disallowed under section 118 and corresponding provisions of prior revenue laws, are deemed nonrecognized losses and do not reduce earnings or profits. The "recognized" gain or loss for the purpose of computing earnings and profits is determined by applying the recognition provisions to the realized gain or loss computed under the provisions of section 115 (l) as distinguished from the realized gain or loss used in computing net income. The application of this paragraph may be illustrated by the following examples:

Example (1). The X Corporation on January 1, 1942, owned stock in the Y Corporation which it had acquired from the Y Corporation in December 1941, in an exchange transaction in which no gain or loss was recognized. The adjusted basis to the X Corporation of the property exchanged by it for the stock in the Y Corporation was $30,000. The fair market value of the stock in the Y Corporation when received by the X Corporation was $930,000. On April 9, 1942, the X Corporation made a cash distribution of $900,000 and, except for the possible effect of the transaction in 1941, had no earnings or profits accumulated after February 28, 1913, and had no earnings or profits for the taxable year. The amount of $900,000 representing the excess of the fair market value of the stock of the Y Corporation over the adjusted basis of the property exchanged therefor was not recognized gain to the X Corporation under the provisions of section 112. Accordingly, the earnings and profits of the X Corporation are not increased by $900,000, the amount of the gain realized but not recognized in the exchange, and the distribution was not a taxable dividend. The basis in the hands of the Y Corporation of the property acquired by it from the X Corporation is $30,000. If such property is thereafter sold by the Y Corporation, gain or loss will be computed on such basis of $30,000, and earnings and profits will be increased or decreased accordingly.

Example (2). On January 2, 1910, the M Corporation acquired nondepreciable property at a cost of $1,000. On March 1, 1913, the fair market value of such property in the hands of the M Corporation was $2,200. On December 31, 1942, the M Corporation transfers such property to the N Corporation in exchange for $1,900 in cash and all the N Corporation stock, which has a fair market value of $1,100. For the purpose of computing the total earnings and profits of the M Corporation the gain on such transaction is $2,000 (the sum of $1,900 in cash and stock worth $1,100 minus $1,000, the adjusted basis for computing gain, determined without regard to March 1, 1913, value). $1,900 of which is recognized under section 112 (c), since this was the amount of money received, although for the purpose of computing net income the gain is only $800 (the sum of

$1,900 in cash and stock worth $1,100, minus $2,200, the adjusted basis for computing gain determined by giving effect to March 1, 1913, value). Such earnings and profits will therefore be increased by $1,900. In computing the earnings and profits of the M Corporation for any period beginning after February 28, 1913, however, the gain arising from the transaction, like the taxable gain, is only $800, all of which is recognized under section 112 (c), the money received being in excess of such amount. Such earnings and profits will therefore be increased by only $800 as a result of the transaction. For increase in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913, see § 29.115–14.

Example (3). On July 31, 1942, the R Corporation owned oil producing property acquired after February 28, 1913, at a cost of $200,000, but having an adjusted basis (by reason of taking percentage depletion) of $100,000 for determining gain in computing net income. However, the adjusted basis of such property to be used in computing gain or loss for the purpose of earnings and profits is, because of the provisions of the third sentence of section 115 (l), $150,000. On such day the R Corporation transferred such property to the S Corporation in exchange for $25,000 in cash and all of the S Corporation stock, which had a fair market value of $100,000. For the purpose of computing net income the R Corporation has realized a gain of $25,000 as a result of this transaction, all of which is recognized under section 112 (c). For the purpose of computing earnings and profits, however, the R Corporation has realized a loss of $25,000, none of which is recognized owing to the provisions of section 112 (e). The earnings and profits of the R Corporation are therefore neither increased nor decreased as a result of the transaction. The adjusted basis of the S Corporation stock in the hands of the R Corporation for purposes of computing earnings and profits, however, will be $125,000 (though only $100,000 for the purpose of computing net income), computed as follows:

Basis of property transferred	$200,000
Less money received on exchange	25,000
Plus gain or minus loss recognized on exchange	None
Basis of stock	175,000
Less adjustments (same as those used in determining adjusted basis of property transferred)	50,000
Adjusted basis on stock	125,000

If, therefore, the R Corporation should subsequently sell the S Corporation stock for $100,000, a loss of $25,000 will again be realized for the purpose of computing earnings and profits, all of which will be recognized and will be applied to decrease the earnings and profits of the R Corporation.

The third sentence of section 115 (l) provides for cases in which the adjustments, prescribed in section 113, to the basis indicated in paragraph (1) or (2) of the first sentence, as the case may be, of section 115 (l), differ from the adjustments to such basis proper for the purpose of determining earnings or profits.

The adjustments provided by the third sentence of section 115 (l) reflect the treatment provided by § 29.115–3 relative to cases where the deductions for depletion and depreciation in computing net income differ from the deductions proper for the purpose of computing earnings and profits. The effect of such third sentence may be illustrated by the following examples:

Example (1). The X Corporation purchased on January 2, 1931, an oil lease at a cost of $10,000. The lease was operated only for the years 1931 and 1932. The deduction for depletion in each of the years 1931 and 1932 amounted to $2,750, of which amount $1,750 represented percentage depletion in excess of depletion based on cost. The lease was sold in 1942 for $15,000. Under section 113 (b) (1) (B), in determining the gain or loss from the sale of the property, the basis must be adjusted for cost depletion of $1,000 in 1931 and percentage depletion of $2,750 in 1932. However, the adjustment of such basis, proper for the determination of earnings and profits, is $1,000 for each year, or $2,000. Hence, the cost is to be adjusted only to the extent of $2,000, leaving an adjusted basis of $8,000 and the earnings and profits will be increased by $7,000, and not by $8,750. The difference of $1,750 is equal to the amount by which the percentage depletion for the year 1932 ($2,750) exceeds the depletion on cost for that year ($1,000) and has already been applied in the computation of earnings and profits for the year 1932 by taking into account only $1,000 instead of $2,750 for depletion in the computation of such earnings and profits (see §§ 29.115–3 and 29.115–6).

Example (2). If, in the preceding example, the property, instead of being sold, is exchanged in a transaction described in section 112 (c) for like property having a fair market value of $7,750 and cash of $7,250, then the increase in earnings and profits amounts to $7,000, that is, $15,000 ($7,750 plus $7,250) minus the base of $8,000. However, in computing net income of the X Corporation, the gain is $8,750, that is, $15,000 minus $6,250 ($10,000 less depletion of $3,750), of which only $7,250 is recognized because the recognized gain cannot exceed the sum of money received in the transaction. Section 112 (c) (1), and corresponding provisions of prior revenue laws. If, however, the cash received was only $2,250 and the value of the property received was $12,750, then the increase in earnings and profits would be $2,250, that amount being the gain recognized under section 112.

For adjustment and allocation of the earnings and profits of the transferor as between the transferor and the transferee in cases where the transfer of property by one corporation to another corporation results in the nonrecognition in whole or in part of gain or loss, see § 29.115–11.

§ 29.115–13 *Effect on earnings and profits of receipt of tax-free distributions requiring adjustment or allocation of basis of stock.* In order to determine the effect on earnings and profits, where a corporation receives (after February 28, 1913) from a second corporation a distribution which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, section 115 (l) prescribes certain rules. It provides that the amount of such distribution shall not increase the earnings and profits of the first or receiving corporation in the following cases: (1) No such increase shall be made in respect of the part of such distribution which (under the law applicable to the year in which the distribution was made) is directly applied in reduction of the basis of the stock in respect of which the distribution was made and (2) no such increase shall be made if (under the law applicable to the year in which the distribution was made) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received. Where, therefore, the law (applicable to the year in which the distribution was made, as, for example, a distribution in 1934 from earnings and profits accumulated prior to March 1, 1913) requires that the amount of such distribution shall be applied against and reduce the basis of the stock with respect to which the distribution was made, there is no increase in the earnings and profits by reason of the receipt of such distribution.' Similarly, where there is received by a corporation a distribution from another corporation in the form of a stock dividend and the law applicable to the year in which such distribution was made requires the allocation, as between the old stock and the stock received as a dividend, of the basis of the old stock, then there is no increase in the earnings and profits by reason of the receipt of such stock dividend even though such stock dividend constitutes income within the meaning of the sixteenth amendment to the Constitution. These principles may be illustrated by the following examples:

Example (1). The X Corporation in 1942 distributed to the Y Corporation, one of its shareholders, $10,000 which was out of earnings or profits accumulated before March 1, 1913, and did not exceed the adjusted basis of the stock in respect of which the distribution was made. This amount of $10,000 was, therefore, a tax-free distribution and under the provisions of section 115 (b) must be applied against and reduce the adjusted basis of the stock in respect of which the distribution was made. The earnings and profits of the Y Corporation are not increased by reason of the receipt of this distribution.

Example (2). The Z Corporation in 1934 had outstanding common and preferred stock of which the Y Corporation held 100 shares of the common and no preferred. The stock had a cost basis to the Y Corporation of $100 per share, or a total cost of $10,000. In December of that year it received a dividend of 100 shares of the preferred stock of the Z Corporation. Such distribution is a stock dividend which, under section 115 (f) of the Revenue Act of 1934, was not taxable and was accordingly not included in the gross income of the Y Corporation. The original cost of $10,000 is allocated to the 200 shares of the Z Corporation none of which has been sold or otherwise disposed of by the Y Corporation. See section 113 (a) (19) and §§ 29.113 (a) (19)–1 and 29.113 (a) (12)–1. The earnings and profits of the Y Corporation are not increased by reason of the receipt of such stock dividend.

§ 29.115–14 *Adjustments to earnings and profits reflecting increase in value accrued prior to March 1, 1913.* In order to determine, for the purpose of ascertaining the source of dividend distributions, that part of the earnings and profits which is represented by increase in value of property accrued before, but realized on or after, March 1, 1913, section 115 (m) prescribes certain rules.

Paragraph (1) of section 115 (m) sets forth the general rule with respect to computing the increase to be made in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or

after, March 1, 1913. The effect of this paragraph may be illustrated by the following examples:

Example (1). The X Corporation acquired nondepreciable property prior to March 1, 1913, at a cost of $10,000. Its fair market value as of March 1, 1913, was $12,000 and it was sold in 1942 for $15,000. The increase in earnings and profits based on the value as of March 1, 1913, representing earnings and profits accumulated since February 28, 1913, is $3,000. If the basis is determined without regard to the value as of March 1, 1913, there would be an increase in earnings and profits of $5,000. The difference of $2,000 ($5,000 minus $3,000) represents the increase to be made in that part of the earnings and profits of the X Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (2). The Y Corporation acquired depreciable property in 1908 at a cost of $100,000. Assuming no additions or betterments, and that the depreciation sustained prior to March 1, 1913, was $10,000, the adjusted cost as of that date was $90,000. Its fair market value as of March 1, 1913, was $94,000 and in 1942 it was sold for $60,000. For the purpose of determining gain from the sale, the basis of the property is the fair market value of $94,000 as of March 1, 1913, adjusted for depreciation for the period subsequent to February 28, 1913, computed on such fair market value. If the amount of the depreciation deduction allowed (not less than the amount allowable) after February 28, 1913, to the date of the sale in 1942 is the aggregate sum of $43,240, the adjusted basis for determining gain in 1942 ($94,000 less $43,240) is $50,760 and the gain would be $9,240 ($60,000 less $50,760). The increase in earnings and profits accumulated since February 28, 1913, by reason of the sale, based on the value as of March 1, 1913, adjusted for depreciation, is $9,240. If the depreciation since February 28, 1913, had been based on the adjusted cost of $90,000 ($100,000 less $10,000) instead of the March 1, 1913, value of $94,000, the depreciation sustained from that date to the date of sale would have been $41,400 instead of $43,240 and the actual gain on the sale based on the cost of $100,000 adjusted by depreciation on such cost to $48,600 ($100,000 reduced by the sum of $10,000 and $41,400) would be $11,400 ($60,000 less $48,600). If the adjusted basis of the property was determined without regard to the value as of March 1, 1913, there would be an increase in earnings and profits of $11,400. The difference of $2,160 ($11,400 minus $9,240) represents the increase to be made in that part of the earnings and profits of the Y Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Paragraph (2) of section 115 (m) is an exception to the general rule in paragraph (1) of such section and also operates as a limitation on the application of section 115 (l). It provides that, if the application of (2) of the first sentence of section 115 (l) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding section 115 (l) and in lieu of the rule provided in paragraph (1) of section 115 (m), the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the fair market value of the property on March 1, 1913. If the amount so applied in reduction of the loss exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913. The following examples will show the application of section 115 (m) (2):

Example (1). The Y Corporation acquired nondepreciable property prior to March 1, 1913, at a cost of $8,000, its fair market value as of March 1, 1913, was $13,000, and it was sold in 1942 for $10,000. Under (2) of the first sentence of section 115 (l) the adjusted basis would be $13,000 and there would be a loss of $3,000. The application of (2) of the first sentence of section 115 (l) would result in a loss from the sale in 1942 to be applied in decrease of earnings and profits for that year. Section 115 (m) (2), however, applies and the loss of $3,000 is reduced by the amount by which the adjusted basis of $13,000 exceeds the cost of $8,000 (the adjusted basis computed without regard to the value on March 1, 1913), namely, $5,000. The amount of the loss is, accordingly, reduced from $3,000 to zero and there is no decrease in earnings and profits of the Y Corporation for the year 1942 as the result of the sale. The amount applied in reduction of the decrease, namely, $5,000, exceeds $3,000. Accordingly, as a result of the sale the excess of $2,000 increases that part of the earnings and profits of the Y Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (2). The Z Corporation acquired nondepreciable property prior to March 1, 1913, at a cost of $10,000, its fair market value as of March 1, 1913, was $12,000, and it was sold in 1942 for $8,000. Under (2) of the first sentence of section 115 (l) the adjusted basis would be $12,000 and there would be a loss of $4,000. The application of (2) of the first sentence of section 115 (l) would result in a loss from the sale in 1942 to be applied in decrease of earnings and profits for that year. Section 115 (m) (2), however, applies and the loss of $4,000 is reduced by the amount by which the adjusted basis of $12,000 exceeds the cost of $10,000 (the adjusted basis computed without regard to the value on March 1, 1913), namely, $2,000. The amount of the loss is, accordingly, reduced from $4,000 to $2,000 and the decrease in earnings and profits of the Z Corporation for the year 1942 as the result of the sale is $2,000 instead of $4,000. The amount applied in reduction of the decrease, namely $2,000, does not exceed $4,000. Accordingly, as the result of the sale there is no increase in that part of the earnings and profits of the Z Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913.

SEC. 116. EXCLUSIONS FROM GROSS INCOME [as amended by sec. 2, Public Salary Tax Act 1939, repealing subsection (b); secs. 148, 149, Rev. Act 1942].

In addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) *Earned income from sources without the United States*—(1) *Foreign resident for entire taxable year.* In the case of an individual citizen of the United States, who establishes to the satisfaction of the Commissioner that he is a bona fide resident of a foreign country or countries during the entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts would constitute earned income as defined in section 25 (a) if received from sources within the United States; but such individuals shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection. [Under the provisions of sec. 148 (b), Rev. Act 1942, this paragraph is applicable with respect to taxable years beginning after December 31, 1942. The corresponding provisions applicable with respect to taxable years beginning in 1942 are as follows: "In the case of an individual citizen of the United States, a bona fide nonresident of the United States for more than six months during the taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts would constitute earned income as defined in section 25 (a) if received from sources within the United States; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection."]

(2) *Taxable year of change of residence to United States.* In the case of an individual citizen of the United States, who has been a bona fide resident of a foreign country or countries for a period of at least two years before the date on which he changes his residence from such country to the United States, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof), which are attributable to that part of such period of foreign residence before such date, if such amounts would constitute earned income as defined in section 25 (a) if received from sources within the United States; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(c) *Income of foreign governments.* The income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments, or from any other source within the United States.

(d) *Income of States, municipalities, etc.* Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.

Whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility—

(1) If by the terms of such contract the tax imposed by this chapter is to be paid out of the proceeds from the operation of such public utility, prior to any division of such proceeds between the person and the State, Territory, political subdivision, or the District of Columbia, and if, but for the imposition of the tax imposed by this chapter, a part of such proceeds for the taxable year would accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then a tax upon the net income from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this chapter, but there shall be refunded to such State, Territory, political subdivision, or the District of Columbia (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount

of the tax as the amount which (but for the imposition of the tax imposed by this chapter) would have accrued directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the net income from the operation of such public utility for such taxable year.

(2) If by the terms of such contract no part of the proceeds from the operation of the public utility for the taxable year would, irrespective of the tax imposed by this chapter, accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then the tax upon the net income of such person from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this chapter.

(e) *Bridges to be acquired by State or political subdivision.* Whenever any State or political subdivision thereof, in pursuance of a contract to which it is not a party entered into before May 29, 1928, is to acquire a bridge—

(1) If by the terms of such contract the tax imposed by this chapter is to be paid out of the proceeds from the operation of such bridge prior to any division of such proceeds, and if, but for the imposition of the tax imposed by this chapter, a part of such proceeds for the taxable year would accrue directly to or for the use of or would be applied for the benefit of such State or political subdivision, then a tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this chapter, but there shall be refunded to such State or political subdivision (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this chapter) would have accrued directly to or for the use of or would be applied for the benefit of such State or political subdivision, bears to the amount of the net income from the operation of such bridge for such taxable year. No such refund shall be made unless the entire amount of the refund is to be applied in part payment for the acquisition of such bridge.

(2) If by the terms of such contract no part of the proceeds from the operation of the bridge for the taxable year would, irrespective of the tax imposed by this chapter, accrue directly to or for the use of or be applied for the benefit of such State or political subdivision, then the tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this chapter.

(f) *Dividend from "China Trade Act" corporation.* In the case of a person, amounts distributed as dividends to or for his benefit by a corporation organized under the China Trade Act, 1922, 42 Stat. 849 (U. S. C., Title 15, c. 4), if, at the time of such distribution, he is a resident of China, and the equitable right to the income of the shares of stock of the corporation is in good faith vested in him.

(g) *Shipowners' protection and indemnity associations.* The receipts of shipowners' mutual protection and indemnity associations not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder; but such corporations shall be subject as other persons to the tax upon their net income from interest, dividends, and rents.

(h) *Compensation of employees of foreign governments or of the Commonwealth of the Philippines.*—(1) *Rule for exclusion.* Wages, fees, or salary of an employee of a foreign government or of the Commonwealth of the Philippines (including a consular or other officer, or a nondiplomatic representative) received as compensation for official services to such government or such Commonwealth—

(A) If such employee is not a citizen of the United States, or is a citizen of the Commonwealth of the Philippines (whether or not a citizen of the United States); and

(B) If the services are of a character similar to those performed by employees of the Government of the United States in foreign countries or in the Commonwealth of the Philippines, as the case may be; and

(C) If the foreign government, or the Commonwealth of the Philippines, whose employee is claiming exemption grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country or such Commonwealth, as the case may be.

(2) *Certificate by Secretary of State.* The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries. If the Commonwealth of the Philippines grants an equivalent exemption to the employees of the United States performing services in such Commonwealth the Secretary of State shall certify such fact to the Secretary of the Treasury and the character of the services performed by employees of the Government of the United States in such Commonwealth.

(i) *Treasury bills.* For exemption from taxation of gain derived from the sale or other disposition of Treasury bills, issued after June 17, 1930, under the second Liberty bond act, as amended, see Act of June 17, 1930, c. 512, 46 Stat. 775 (U.S.C., Title 31, § 754).

§ 29.116–1 *Earned income from sources without the United States.* For taxable years beginning after December 31, 1942, there is excluded from gross income earned income in the case of an individual citizen of the United States provided the following conditions are met by the taxpayer claiming such exclusion from his gross income: (a) It is established to the satisfaction of the Commissioner that the taxpayer has been a bona fide resident of a foreign country or countries throughout the entire taxable year; (b) such income is from sources without the United States; (c) the income constitutes earned income as defined in section 25 (a) if received from sources within the United States; and (d) such income does not represent amounts paid by the United States or any agency or instrumentality thereof. Hence, a citizen of the United States taking up residence without the United States in the course of the taxable year is not entitled to such exemption for such taxable year. However, once bona fide residence in a foreign country or countries has been established, temporary absence therefrom in the United States on vacation or business trips will not necessarily deprive such individual of his status as a bona fide resident of a foreign country. Whether the individual citizen of the United States is a bona fide resident of a foreign country shall be determined in general by the application of the principles of §§ 29.211–2, 29.211–3, 29.211–4, and 29.211–5 relating to what constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual.

For any taxable year beginning after December 31, 1941, in the case of an individual citizen of the United States, there shall be excluded from gross income earned income from sources without the United States derived during the period of his foreign residence if (1) such citizen was a bona fide resident of a foreign country or countries for at least two years prior to the date upon which he became a resident of the United States and ceased to be a resident of such foreign country or countries; (2) such amounts would constitute earned income as defined in section 25 (a) if received from sources within the United States; and (3) such income does not represent amounts paid by the United States or any agency or instrumentality thereof. The application of this provision may be illustrated by the following example:

Example. A, a United States citizen making his return on a calendar year basis, has been a resident of X country for a period of four years ended June 30, 1942, upon which date he becomes a resident of the United States and ceases to be a resident of X country. Throughout the years 1940 and 1941, A had rendered personal services in the X country payment for which was not made until August 1942, at which time he was paid for such services the sum of $50,000. Such amount may be excluded from gross income of A for the calendar year 1942.

In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 116 (a), there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions properly applicable to or chargeable against the amounts so excluded from gross income.

§ 29.116–2 *Income of foreign governments, ambassadors, and consuls.* The exemption of the income of foreign governments applies also to their political subdivisions. Any income collected by foreign governments from investments in the United States in stocks, bonds, or other domestic securities, which are not actually owned by but are loaned to such foreign governments, is subject to tax.

All employees of a foreign government (including consular or other officers, or nondiplomatic representatives) who are not citizens of the United States are exempt from Federal income tax with respect to wages, fees, or salaries received by them as compensation for official services rendered in the United States to such foreign government, provided (1) the services are of a character similar to those performed by employees of the Government of the United States in such foreign country and (2) the foreign government whose employees are claiming exemption grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country. Section 116 (h) (2) provides that the Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Govern-

ment of the United States in foreign countries. The income received by employees of foreign governments from sources other than their salaries, fees, or wages, referred to above, is subject to Federal income tax. The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from income tax. (But see section 116 (a).) Subject to the same conditions, wages, fees, or salaries of an employee of the Commonwealth of the Philippines received as compensation for official services rendered to such commonwealth are exempt from Federal income tax subject to the same kind of certification by the Secretary of State to the Secretary of the Treasury. Such latter exemption does not apply to a citizen of the United States unless he is also a citizen of the Commonwealth of the Philippines. (See section 251.) Under the provisions of the tax convention between the United States and France, and without regard to any other provision of this section, compensation paid by France to French citizens for labor or personal services performed in the United States is exempt from Federal income tax. Similarly, under the provisions of the tax convention between the United States and Sweden, wages, salaries, and similar compensation and pensions paid by Sweden or by any political subdivision or territory or possession thereof to individuals (other than citizens of the United States) residing in the United States are also exempt from Federal income tax. Similarly, under the tax convention between the United States and Canada (effective January 1, 1941), wages, salaries, and similar compensation paid by Canada or by any agency or instrumentality thereof or by any of the political subdivisions or territories or possessions of Canada to citizens of Canada residing in the United States are also exempt from Federal income tax.

§ 29.116–3 *Bridges to be acquired by State or political subdivisions.* (a) Any State or political subdivision thereof claiming a refund under the provisions of section 116 (e) of an amount equal to all or a portion of any income tax levied, assessed, collected, and paid in the manner and at the rates prescribed in chapter 1, shall file a claim therefor on Form 843 (to which there shall be attached as exhibits the matter hereinafter prescribed) with the collector of internal revenue for the district in which the tax was paid, which claim shall be executed on behalf of such State or political subdivision thereof by the treasurer or other fiscal officer thereof and shall contain:

(1) A statement of the name of the taxpayer, of the amount of tax levied, assessed, collected, and paid for the taxable year or period in respect of which the claim is made, and the amount of refund thereby sought;

(2) A full statement of the facts considered by the claimant sufficient to entitle it to receive the refund, including copies of all contracts and other documents bearing on the case, and a statement that the claim is submitted under the provisions of section 116 (e);

(3) A showing which will establish to the satisfaction of the Commissioner that the fiscal officer presenting the claim has authority to receive the amount of the refund on behalf of the State or political subdivision which he assumes to represent and to apply without delay the entire amount of such refund in part payment for the acquisition of such bridge, including copies of the laws, ordinances, or similar enactments considered by the claimant sufficient to establish its authority to receive the refund and so to apply it, together with a statement that such fiscal officer will receive and immediately so apply the entire amount of the refund; and

(4) An affidavit made by or on behalf of the taxpayer, which affidavit shall state that the taxpayer thereby joins with and concurs in the request of the State or political subdivision thereof that a refund of an amount equal to all or a portion of the tax previously paid by such taxpayer be made to such State or political subdivision, that the taxpayer agrees to receive the amount refunded from the State or political subdivision to which it is paid and immediately to apply the entire amount of such refund in part payment for the acquisition of such bridge, and that if for any reason the contract which is the basis of the claim for refund is not fully executed and performed, the taxpayer will repay to the United States upon its demand the entire amount of the refund with interest at 6 percent per annum from the date the refund is made without seeking or claiming the benefit of any statute of limitations which prior thereto may have run against the United States.

(b) No refund shall be made of any amount in excess of the amount of the tax levied, assessed, collected, and paid by the taxpaper for any taxable year or period. A separate claim shall be made in respect of each separate taxable year or period. If by the terms of the contract on which the claim is based two or more States or political subdivisions of a State or States are entitled to acquire the bridge, the claim for refund in respect of each separate taxable year or period must be made jointly by the States or political subdivisions thereof so entitled. The amount refunded under section 116 (e) and this section is not considered an overpayment within the meaning of section 3771 relating to interest on overpayments, and no interest shall be allowed or paid upon the amount of the refund.

(c) A check or voucher in payment of a claim for refund allowed under section 116 (e) will be drawn in the name of the fiscal officer or officers having authority, as established under paragraph (a) (3) of this section, to receive the same, and will contain an express provision that it is issued for the sole purpose and subject to the conditions prescribed in section 116 (e) and this section.

SEC. 117. CAPITAL GAINS AND LOSSES [as amended by secs. 212 (a) (b), 214 (c), Rev. Act 1939; sec. 115 (b), Rev. Act 1941; secs. 150 (a) (b) (c) (d), 151 (a) (b) (c), 152, Rev. Act 1942].

(a) *Definitions.* As used in this chapter—

(1) *Capital assets.* The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(2) *Short-term capital gain.* The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(3) *Short-term capital loss.* The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

(4) *Long-term capital gain.* The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

(5) *Long-term capital loss.* The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;

(6) *Net short-term capital gain.* The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year;

(7) *Net short-term capital loss.* The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) *Net long-term capital gain.* The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) *Net long-term capital loss.* The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(10) *Net capital gain*—(A) *Corporations.* In the case of a corporation, the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges; and

(B) *Other taxpayers.* In the case of a taxpayer other than a corporation, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from such sales or exchanges. For purposes of this subparagraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

(11) *Net capital loss.* The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the sum allowed under subsection (d). For the purpose of determining losses under this paragraph, amounts which are short-term capital losses under subsection (e) (1) shall be excluded.

(b) *Percentage taken into account.* In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

(c) *Alternative taxes*— (1) *Corporations.* If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 13, 14, 15, 204, 207 (a) (1) or (3), and 500, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 25 per centum of such excess.

(2) *Other taxpayers.* If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 50 per centum of such excess.

(d) *Limitation on capital losses*—(1) *Corporations.* In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(2) *Other taxpayers.* In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of[1] $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

(e) *Capital loss carry-over*—(1) *Method of computation.* If for any taxable year beginning after December 31, 1941, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. For purposes of this paragraph a net capital gain shall be computed without regard to such net capital loss or to any net capital losses arising in any such intervening taxable years.

(2) *Rule for application of capital loss carry-over from 1941.* The amount of the net short-term capital loss of the last taxable year beginning in 1941 (computed without regard to amounts treated as short-term capital losses from the preceding taxable year), which is not in excess of the net income for such taxable year, shall, to the extent of the net short-term capital gain for the succeeding taxable year (computed without regard to this paragraph), be a short-term capital loss of such succeeding taxable year.

(f) *Retirement of bonds, etc.* For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

(g) *Gains and losses from short sales, etc.* For the purpose of this chapter—

(1) gains or losses from short sales of property shall be considered as gains or losses from sales or exchanges of capital assets; and

(2) gains or losses attributable to the failure to exercise privileges or options to buy or sell property shall be considered as short-term capital gains or losses.

(h) *Determination of period for which held.* For the purpose of this section—

(1) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged. For the purposes of this paragraph, an involuntary conversion described in section 112 (f) shall be considered an exchange of the property converted for the property acquired.

(2) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(3) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain was recognized to the distributee under the provisions of section 112 (g) of the Revenue Act of 1928, 45 Stat. 818, or the Revenue Act of 1932, 48 Stat. 705, or under the provisions of section 371 (c) of the Revenue Act of 1938 or this chapter, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(4) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this chapter or section 118 of the Revenue Act of 1928, 45 Stat. 826, or the Revenue Act of 1932, 47 Stat. 208, or the Revenue Act of 1934, 48 Stat. 715, or the Revenue Act of 1936, 49 Stat. 1692, or the Revenue Act of 1938, 52 Stat. 503, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible.

(5) In determining the period for which the taxpayer has held stock or rights to acquire stock received upon a distribution, if the basis of such stock or rights is determined under section 113 (a) (19) (A), there shall (under regulations prescribed by the Commissioner with the approval of the Secretary) be included the period for which he held the stock in the distributing corporation prior to the receipt of such stock or rights upon such distribution.

(6) In determining the period for which the taxpayer has held stock or securities acquired from a corporation by the exercise of rights to acquire such stock or securities, there shall be included only the period beginning with the date upon which the right to acquire was exercised.

(i) *Bond, etc., losses of banks.* For the purposes of this chapter, in the case of a bank, as defined in section 104, if the losses of the taxable year from sales or exchanges of bonds, debentures, notes, or certificates, or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof) with interest coupons or in registered form, exceed the gains of the taxable year from such sales or exchanges, no such sale or exchange shall be considered a sale or exchange of a capital asset.

(j) *Gains and losses from involuntary conversion and from the sale or exchange of certain property used in the trade or business*— (1) *Definition of property used in the trade or business.* For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(2) *General rule.* If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

§ 29.117–1 *Meaning of terms.* The term "capital assets" includes all classes of property not specifically excluded by section 117 (a) (1). In determining whether property is a "capital asset," the period for which held is immaterial.

The exclusion from the term "capital assets" of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23 (l) and of real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. Gains and losses from the sale or exchange of such property are not subject to the percentage provisions of section 117 (b) and losses from such transactions are not subject to the limitations on losses provided in section 117 (d), except that under section 117 (j) the gains and

[1] So in original.

losses from the sale or exchange of such property held for more than six months may be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See § 29.117–7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23 (l) prior to its amendment by the Revenue Act of 1942. However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the limitations of section 117 (b), (c), and (d). The term "ordinary net income" as used in these regulations for the purpose of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

Obligations of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, are excluded from the term "capital assets." An obligation may be issued on a discount basis even though the price paid exceeds the face amount. Thus, although the Second Liberty Bond Act provides that United States Treasury bills shall be issued on a discount basis, the issuing price paid for a particular bill may, by reason of competitive bidding, actually exceed the face amount of the bill. Since the obligations of the type described in this paragraph are excluded from the term "capital assets," gains or losses from the sale or exchange of such obligations are not subject to the percentage provisions of section 117 (b) and losses from such transactions are not subject to the limitation on losses provided in section 117 (d). It is, therefore, not necessary for a taxpayer, other than a life insurance company subject to taxation only on interest, dividends, and rents, to segregate the original discount accrued (see § 29.42–7) and the gain or loss realized upon the sale or other disposition of any such obligation.

Example (*1*). A (not a life insurance company) buys a $100,000 90-day Treasury bill upon issuance for $99,998. As of the close of the forty-fifth day of the life of such bill, he sells it to B (not a life insurance company) for $99,999.50. The entire net gain to A of $1.50 may be taken into account as a single item of income, without allocating $1 to interest and $0.50 to gain. If B holds the bill until maturity his net gain of $0.50 may similarly be taken into account as a single item of income, without allocating $1 to interest and $0.50 to loss.

Example (*2*). The facts in this example are the same as in example (1) except that the selling price to B is $99,998.50. The net gain to A of $0.50 may be taken into account without allocating $1 to interest and $0.50 to loss, and, similarly, if B holds the bill until maturity his entire net gain of $1.50 may be taken into account as a single item of income without allocating $1 to interest and $0.50 to gain.

Section 117 (a) (2) to (9), inclusive, defines "short-term capital gain," "short-term capital loss," "long-term capital gain," "long-term capital loss," "net short-term capital gain," "net short-term capital loss," "net long-term capital gain," and "net long-term capital loss." These terms are used in the subsequent subsections of section 117.

The phrase "short-term" applies to the category of gains and losses arising from the sale or exchange of capital assets held for six months or less; the phrase "long-term" to the category of gains and losses arising from the sale or exchange of capital assets held for more than six months. The fact that some part of a loss from the sale or exchange of a capital asset may be finally disallowed because of the operation of section 117 (d) does not mean that such loss is not "taken into account in computing net income" within the meaning of that phrase as used in section 117 (a) (3) and (5).

In the definition of "net short-term capital gain," as provided in section 117 (a) (6), the amounts brought forward to the taxable year under section 117 (e) are short-term capital losses for such taxable year.

Gains and losses from the sale or exchange of capital assets held for not more than six months (described as short-term capital gains and short-term capital losses) shall be segregated from gains and losses arising from the sale or exchange of such assets held for more than six months (described as long-term capital gains and long-term capital losses). The percentage brackets of section 117 (b) have no application to corporations, corporate gains and losses being taken into account to the full extent, without regard to the length of time the capital assets are held (though because of the limitation in section 117 (d) such losses may not be deductible in full).

Section 117 (a) (10) defines "net capital gain." In the case of a corporation the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges, which losses include any amounts brought forward pursuant to section 117 (e). In the case of a taxpayer other than a corporation the term "net capital gain" means the excess of (1) the sum of the gains from sales or exchanges of capital assets, plus net income (computed without regard to gains and losses from sales or exchanges of capital assets) of the taxpayer or $1,000, whichever is smaller, over (2) the losses from such sales or exchanges, which losses include amounts brought forward under section 117 (e). For application of the term "net capital gain," in computing the capital loss carry-over under section 117(e), see § 29.117–2 (c).

Section 117 (a) (11) defines "net capital loss" to mean the excess of the losses from sales or exchanges of capital assets over the sum allowed under section 117 (d). However, amounts which are short-term capital losses under section 117 (e) (1) are excluded in determining such "net capital loss."

See section 23 (g) and (k), under which losses from worthless stocks, bonds, and other securities (if they constitute capital assets) are required to be treated as losses under section 117 from the sale or exchange of capital assets, even though such securities are not actually sold or exchanged. See also section 117 (j) and § 29.117–7 for the determination of whether or not gains and losses from the involuntary conversion of capital assets and from the sale, exchange, or involuntary conversion of certain property used in the trade or business shall be treated as gains and losses from the sale or exchange of capital assets.

§ 29.117–2 *Percentage of capital gain or loss taken into account; net loss carry-over*—(a) *General.* In computing the net income of a taxpayer, other than a corporation, the amount of the gain or loss, computed under section 111 and recognized under section 112, upon the sale or exchange of a capital asset shall be taken into account only to the extent provided in section 117 (b). The percentage of the gain or loss to be taken into account ranges from 100 percent to 50 percent, depending upon the period for which the asset was held. For instance, if unimproved real estate purchased by an individual for $20,000 is a capital asset and is sold by him for $25,000 after having been held for more than six months, only 50 percent of the recognized gain ($5,000), or $2,500, shall be taken into account in computing net income; or if such property is sold for $14,000, only 50 percent of the recognized loss ($6,000), or $3,000, shall be so taken into account.

(b) *Limitation on capital losses.* Section 117 (d) (1) provides that, in the case of a corporation, losses from sales or exchanges of capital assets shall be allowed as deductions only to the extent of the gains from such sales or exchanges, and section 117 (d) (2) provides that, in the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed as a deduction only to the extent of the gains from such sales or exchanges, plus net income (computed without regard to such gains or losses) of the taxpayer or $1,000, whichever is smaller. Thus, where an individual taxpayer, having an ordinary net income of $5,000 has a net long-term capital loss of $4,000, of which $2,000 (50% of $4,000) is taken into account, the net loss of $2,000 is allowable only to the extent of $1,000, the remaining $1,000 being an unallowable deduction. If the taxpayer's ordinary net income, computed without capital gains and losses, had been $400 instead of $5,000, only $400 of the net loss of $2,000 would have been allowed, giving the taxpayer no taxable income and an unallowable capital loss of $1,600. (For disposition of the unallowable capital loss, see paragraph (c) of this section.) However, in the case of banks, as defined in section 104, the limitation under section 117 (d) (1) is modified by section 117 (i) so that the excess of any losses of the taxable year from sales or exchanges of

bonds, debentures, notes or certificates, or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof) with interest coupons or in registered form, over gains of the taxable year from such sales or exchanges may be deductible in full as an ordinary loss.

(c) *Net capital loss carry-over.* Any taxpayer sustaining a net capital loss may, under section 117 (e) (1), carry over such loss to each of the five succeeding taxable years and treat it in each such five succeeding taxable years as a short-term capital loss to the extent not allowed as a deduction against any net capital gains of any taxable years intervening between the taxable year in which the net capital loss was sustained and the taxable year to which carried. The carry-over is thus applied in each succeeding taxable year to offset any net capital gain in such succeeding taxable year. The amount of the net capital loss carry-over may not be included in computing a new net capital loss of a taxable year which can be carried forward to the next five succeeding taxable years.

The practical operation of the provisions of section 117 (e) (1) may be illustrated by the following example:

Example. For the taxable years 1942 to 1946, inclusive, a taxpayer is assumed to have a net short-term capital loss, net short-term capital gain, net long-term capital loss, net long-term capital gain, and net income as follows:

	1942	1943	1944	1945	1946
Carry-over from prior years:					
From 1942	----------	($50,000)	($29,500)	$(29,500)	----------
From 1944	----------	----------	----------	(19,500)	($13,000)
Net short-term loss (computed without regard to the carry-overs)	($30,000)	(5,000)	(10,000)	----------	----------
Net short-term gain (computed without regard to the carry-overs)	----------	----------	----------	40,000	----------
Net long-term loss	(20,500)	----------	(10,000)	(5,000)	----------
Net long-term gain	----------	25,000	----------	----------	----------
Net capital gain (computed without regard to the carry-overs)	----------	20,500	----------	36,000	----------
Net income (computed without regard to capital gains or losses)	500	500	500	1,000	----------
Net capital loss	(50,000)	None	(19,500)	None	----------

Net Capital Loss of 1942

The net capital loss is $50,000. This figure, computed in accordance with section 117 (b), is the excess of the losses from sales or exchanges of capital assets over the sum of (1) gains from such sales or exchanges, and (2) net income of $500. This amount may be carried forward in full to 1943. However, in 1943 there was a net capital gain of $20,500, as defined by section 117 (a) (10) (B) and limited by section 117 (e) (1), against which this net capital loss of $50,000 is allowed in part. The remaining portion—$29,500—may be carried forward to 1944 and 1945 since there was no net capital gain in 1944. In 1945 this $29,500 shall be allowed in full against net capital gain of $36,000, as defined by section 117 (a) (10) (B) and limited by section 117 (e) (1).

Net Capital Loss of 1944

The net capital loss is $19,500. This figure, computed in accordance with section 117 (b), is the excess of the losses from sales or exchanges of capital assets over the sum of (1) gains from such sales or exchanges and (2) net income of $500. This amount may be carried forward in full to 1945. However, in 1945 there was a net capital gain of $6,500, as defined by section 117 (a) (10) (B) and limited by section 117 (e) (1), against which this net capital loss of $19,500 is allowed in part. The remaining portion—$13,000—may be carried forward to 1946.

§ 29.117–3 *Alternative tax in case of net long-term capital gain or loss.* In case the net long-term capital gain of a taxpayer (other than a corporation) exceeds the net short-term capital loss, section 117 (c) (2) imposes an alternative tax in lieu of the tax imposed by sections 11 and 12, if and only if such alternative tax is less than the tax imposed by sections 11 and 12. For any such taxable year this alternative tax is the sum of (1) a partial tax, computed at the rates provided by sections 11 and 12, on the net income of the taxpayer, excluding therefrom for this purpose the amount of such excess of the net long-term capital gain over the net short-term capital loss, plus (2) 50 percent of such excess.

In case the net long-term capital gain of any corporation exceeds the net short-term capital loss, section 117 (c) (1) imposes an alternative tax in lieu of the tax imposed by sections 13, 14, 15, 204, 207 (a) (1) or (3), and 500, if and only if such alternative tax is less than the tax imposed by such sections. For any such taxable year this alternative tax is the sum of (1) a partial tax computed at the rates provided by sections 13, 14, 15, 204, 207 (a) (1) or (3), and 500 on the net income of the taxpayer, excluding therefrom for this purpose the amount of such excess of the net long-term capital gain over the net short-term capital loss, plus (2) 25 percent of such excess.

The following example will illustrate the practical operation of the provisions of this section in the case of a taxpayer other than a corporation:

Example. Suppose that A, an individual, has for the calendar year 1942 an ordinary net income of $100,000, none of which consists of interest on the obligations of the United States or its instrumentalities. He is entitled to a personal exemption of $1,200 and to no credit for dependents, and his earned net income is $3,000. He realizes in that year a gain of $100,000 on a capital asset held for 19 months and sustained a loss of $20,000 on a capital asset held for 5 months. Since the alternative tax is less than the tax otherwise computed under sections 11 and 12, the correct tax is the alternative tax, that is, $79,126. The tax is computed as follows:

Tax Under Sections 11 and 12

Ordinary net income		$100,000.00
Net long-term capital gain: (50 percent of $100,000)	$50,000.00	
Net short-term capital loss: (100 percent of $20,000)	20,000.00	
Excess of the net long-term capital gain over the net short-term capital loss		$30,000.00
Total net income		130,000.00
Less:		
Credit for personal exemption		1,200.00
Surtax net income		128,800.00
Less earned income credit (10 percent of $3,000)		300.00
Income subject to normal tax		128,500.00
Normal tax (6 percent of $128,500)		7,710.00
Surtax on $128,800		81,892.00
Total tax		89,602.00

Alternative Tax Under Section 117 (c) (2)

Net income		$130,000.00
Less:		
Excess of the net long-term capital gain over the net short-term capital loss		30,000.00
Ordinary net income		100,000.00
Less credit for personal exemption		1,200.00
Surtax net income		98,800.00
Less earned income credit (10 percent of $3,000)		300.00
Income subject to normal tax		98,500.00
Normal tax (6 percent of $98,500)		5,910.00
Surtax on $98,800		58,216.00
Partial tax under sections 11 and 12 on $100,000		64,126.00
Plus 50 percent of $30,000		15,000.00
Total alternative tax		79,126.00

§ 29.117–4 *Determination of period for which capital assets are held.* Under section 117 (h) if property is acquired in certain transactions described in sections 112, 113, 118, and 371 (c), the period for which such property is considered to have been held by the taxpayer is not computed from the date such property was acquired by the taxpayer but from a prior date. For instance: In the case of stock or securities in a corporation a party to a reorganization received pursuant to a plan of reorganization in exchange solely for stock or securities in another corporation a party to the reorganization, the period for which the stock or securities exchanged were held by the taxpayer must be included in the period for which the stock or securities received on the exchange were held by the taxpayer. In the case of property acquired after December 31, 1920, by gift (if under the provisions of section 113, such property has, for the purpose of determining gain or loss from the sale or exchange, the same basis in the hands of the taxpayer as it would have in the hands of the donor), the period for which the property was held by the donor must be included in the period for which the property was held by the taxpayer. In the case of stock or securities the acquisition of which resulted in the nondeductibility (under section 118 of the Internal Revenue Code or under section 118 of the Revenue Act of 1928, 1932, 1934, 1936, or 1938) of the loss from the sale or other disposition of

substantially identical stock or securities, the period for which the stock or securities the loss from the sale or other disposition of which was not deductible were held must be included in the period for which the stock or securities acquired were held by the taxpayer. If property acquired as the result of a compulsory or involuntary conversion of other property of the taxpayer has under section 113 (a) (9) the same basis in whole or in part in the hands of the taxpayer as the property so converted, the period for which the property so converted was held by the taxpayer must be included in the period for which the property acquired was held by the taxpayer.

The period for which the taxpayer has held stock, or stock subscription rights, issued to him as a dividend shall be determined as though the stock dividend, or stock right, as the case may be, were the stock in respect of which the dividend was issued if the basis for determining gain or loss upon the sale or other disposition of such stock dividend or stock right is fixed by the apportionment of the basis of such old stock.

The period for which the taxpayer has held stock or securities issued to him by a corporation pursuant to the exercise by him of rights to acquire such stock or securities from the corporation will, in every case and whether or not the receipt of taxable gain was recognized in connection with the distribution of the rights, begin with and include the day upon which the rights to acquire such stock or securities were exercised. A taxpayer will be deemed to have exercised rights received from a corporation to acquire stock or securities therein where there is an expression of assent to the terms of such rights made by the taxpayer in the manner requested or authorized by the corporation.

§ 29.117–5 *Application of section 117 in the case of husband and wife*—(a) *Taxable year beginning in 1942.* If a husband and wife making a joint return for the first taxable year beginning in 1942, did not make a joint return for the preceding taxable year, the individual net short-term capital loss of each spouse for the preceding taxable year (in an amount not in excess of the individual net income of such spouse for such year) shall be totaled and such total shall be a short-term capital loss for such first taxable year beginning in 1942, to the extent of the excess of short-term capital gains over short-term capital losses for such year. If, however, a joint return was made for such preceding taxable year, a net short-term capital loss as shown by such joint return (in an amount not in excess of the aggregate net income for such year as shown by such return) shall be a short-term capital loss for the first taxable year beginning in 1942, to the extent of the excess of short-term capital gains over the short-term capital losses for such year. If a husband and wife making separate returns for the first taxable year beginning in 1942, made a joint return for the preceding taxable year, a net short-term capital loss shown by such joint return shall be allocated to the spouses on the basis of their individual net short-term capital losses for such preceding taxable year, and the net short-term capital loss allocated to each spouse (in an amount not in excess of the portion of the aggregate net income shown by such joint return attributable to such spouse) shall be treated as a short-term capital loss of such spouse for the first taxable year beginning in 1942 to the extent of the excess of short-term capital gains over short-term capital losses of such spouse for such year.

(b) *Taxable years beginning after December 31, 1942.* In the case of a husband and wife making a joint return, the limitation under section 117 (d) (2), relating to the allowance of losses from sales or exchanges of capital assets, is to be computed and the net capital loss determined with respect to the combined capital gains and losses of the spouses.

If a husband and wife making a joint return for any taxable year beginning after December 31, 1942, did not make a joint return for the preceding taxable years (not exceeding five taxable years and beginning after December 31, 1941), the individual net capital loss of each spouse for each of such preceding taxable years shall be a short-term capital loss for the taxable year to the extent provided by section 117 (e) (1). If, however, a joint return was made for each of the preceding taxable years (not exceeding five taxable years and beginning after December 31, 1941), a net capital loss as shown by each joint return shall be a short-term capital loss for the taxable year to the extent provided by section 117 (e) (1). If a husband and wife making separate returns for any taxable year beginning after December 31, 1942, made a joint return for each of the preceding taxable years (not exceeding five taxable years and beginning after December 31, 1941), a net capital loss as shown by each such joint return shall be allocated to the spouses on the basis of their individual net capital losses for each of such preceding taxable years, and the net capital loss allocated to each spouse shall be a short-term capital loss of such spouse for the taxable year, to the extent provided by section 117 (e) (1).

The alternative taxes computed under section 117 (c) (2) are in lieu of taxes imposed by sections 11 and 12 and must be compared with the tax imposed by such sections to determine which tax is applicable. In computing the alternative taxes under section 117 (c) (2), in the case of a joint return, the determination of the excess of the net long-term capital gains over the net short-term capital losses is to be made by combining the long-term capital gains and losses and the short-term capital gains and losses of the spouses.

§ 29.117–6 *Gains and losses from short sales.* For income tax purposes, a short sale is not deemed to be consummated until delivery of property to cover the short sale, and the percentage of the recognized gain or loss to be taken into account under section 117 (b) from a short sale shall be computed according to the period for which the property so delivered was held. Thus, if a taxpayer made a short sale of shares of stock and covered the short sale by purchasing and delivering shares which he held for not more than six months, 100 percent of the recognized gain or loss would be taken into account under section 117 (b), even though he had on hand other shares of the same stock which he held for more than six months. If the short sale is made through a broker and the broker borrows property to make delivery, the short sale is not deemed to be consummated until the obligation of the seller created by the short sale is finally discharged by delivery of property to the broker to replace the property borrowed by the broker.

§ 29.117–7 *Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.* Section 117 (j) provides that the recognized gains and losses:

(a) From the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is:

(1) Of a character subject to the allowance for depreciation provided in section 23 (l), or

(2) Real property, and

(b) From the involuntary conversion of capital assets held for more than six months

shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

In determining whether such gains exceed such losses for the purposes of section 117 (j), losses upon the destruction in whole or in part, theft or seizure, requisition or condemnation of the property described in section 117 (j) are included whether or not there was a conversion of such property into money or other property. For example, if a capital asset held for more than six months, with an adjusted basis of $400, is stolen, and the loss from this theft is not compensated for by insurance or otherwise, the $400 loss is included in the computations under section 117 (j) to determine whether gains exceed losses. Furthermore, in making this computation, the gains and losses described in section 117 (j) are taken into account without regard to the percentage provisions of section 117 (b), that is, 100 percent of such gains and losses is taken into account. For example, if a taxpayer sustains a loss of $400 upon the sale under threat of condemnation of a capital asset, held for more than six months, such loss is taken into account for the purposes of section 117 (j) to the extent of $400, even though only $200 would be taken into account under section 117 (b) in computing net income. Similarly, the provisions of section 117 (d) limiting the deduction of capital losses are not applicable to exclude any losses from the computations under section 117 (j).

With these exceptions as to sections 117 (b) and 117 (d), gains and losses are included in the computations under section 117 (j) only to the extent that they are taken into account in computing net income. Thus, losses which are not deductible items under section 24 or section 118 are not included in the computations under section 117 (j). Similarly, if a taxpayer reports on the installment basis under section 44 the gain on the sale of property described in section 117 (j), only the portion of the gain reported under section 44 in computing net income for the taxable year is included in the computations for such taxable year under section 117 (j). Any gains and losses which are not recognized under section 112 are not included in the computations under section 117 (j). Thus, if property is involuntarily converted into similar property, so that the gain on such conversion is not recognized under the provisions of section 112 (f), such gain is not included in the computations under section 117 (j).

If it is determined under the above computations that the gains exceed the losses, all of such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than six months. All such gains and losses are then subject to the limitations of section 117 (b), (c), and (d), relating to the percentage taken into account, the alternative tax in the case of capital gains and losses, and the extent to which capital losses are allowed. If it is determined under the above computations that the gains do not exceed the losses, none of such gains and losses are treated as gains and losses from the sale or exchange of capital assets. Such gains and losses are then not subject to the percentage limitations of section 117 (b), and such losses are not subject to the limitations provided in section 117 (d). For example, if the taxpayer during the taxable year has losses of $1,000 on the sale of certain depreciable machinery used in his trade or business, held for more than six months, and a gain of $400 on the sale under threat of condemnation of a capital asset held for more than six months, such losses exceed such gain, and such losses and gain are not treated as losses and gain from the sale or exchange of capital assets. The gain on the sale of the capital asset would therefore be taken into account in full, instead of to the extent of 50 percent as provided in section 117 (b).

Section 117 (j) does not apply to gains and losses on the sale, exchange, or involuntary conversion of any property which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or which is held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. The involuntary conversion of property described in section 117 (j) is the conversion of such property into money or other property as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof.

The following examples will illustrate the operation of the provisions of section 117 (j):

Example (1). A, an individual, makes his income tax return on the calendar year basis. A's recognized gains and losses for 1942 of the kind described in section 117 (j), computed without regard to the limitations in section 117 (b), are as follows:

	Gains	*Losses*
1. Gain on sale of machinery, used in the business and subject to an allowance for depreciation, held for more than six months	$4,000	
2. Gain reported in 1942 (under section 44) on installment sale in 1941 of factory premises used in the business (including building and land, each held for more than six months)	6,000	
3. Gain reported in 1942 (under section 44) on installment sale in 1942 of land held for more than six months, used in the business as a storage lot for trucks	2,000	
4. Gain on proceeds from requisition by Government of boat, held for more than six months, used in the business and subject to an allowance for depreciation	500	
5. Loss upon the destruction by fire of warehouse, held for more than six months and used in the business (excess of adjusted basis of warehouse over compensation by insurance, etc.)		$3,000
6. Loss upon theft of unregistered bearer bonds, held for more than six months		5,000
7. Loss in storm of pleasure yacht, purchased in 1940 for $1,800 and having a fair market value of $1,000 at the time of the storm		1,000
8. Total gains	12,500	
9. Total losses		9,000
10. Excess of gains over losses	3,500	

Since the aggregate of the respective recognized gains ($12,500) exceeds the aggregate of such losses ($9,000), such gains and losses are treated under section 117 (j) as gains and losses from the sale or exchange of capital assets held for more than six months. Therefore, under the provisions of section 117 (b), A will take into account only 50 percent of the amounts of items 1 to 7. Such items are treated the same as any other long-term gains and losses of A, and will cause the inclusion of $1,750 (50 percent of item 10) in computing his net long-term capital gain for the purposes of the alternative tax provided by section 117 (c) (2).

Example (2). A's yacht, used for pleasure and acquired for such use in 1935 at a cost of $25,000, was requisitioned by the Government in 1942 for $15,000. A sustained no deductible loss, and no loss with respect to such requisition will be included in the computations under section 117 (j).

Example (3). If in example (1) the taxpayer were a corporation, then there would be taken into account 100 percent of the gains and losses in items 1 to 7, which are treated for all purposes as gains and losses from the sale or exchange of capital assets held for more than six months. The percentage provisions of section 117 (b) do not apply to corporations. These items will cause the inclusion of $3,500 (item 10) in computing the net long-term capital gain of the corporation for the purposes of the alternative tax provided by section 117 (c) (1).

Example (4). If in example (1) A also had a loss of $4,000 from the sale under threat of condemnation of a capital asset held for more than six months, then the gains ($12,500) would not exceed the losses ($9,000 plus $4,000, or $13,000). Neither the loss on such sale of a capital asset nor any of the other items set forth in example (1) would then be treated as gains and losses from the sale or exchange of capital assets, but all of such items would be treated as ordinary gains and losses. Since all of such items are included in full in computing net income, the net effect of such items will be the inclusion in computing net income of a loss of $500 (the excess of the $13,000 losses over the $12,500 gains). This same result would be obtained if A were a corporation. If the loss on the sale of the capital asset under threat of condemnation were $3,500, the gains and losses would still be treated as ordinary gains and losses and not as capital gains and losses, since the gains ($12,500) would not exceed the losses ($9,000 plus $3,500, or $12,500).

SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES. (a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

(b) If the amount of stock or securities acquired (or covered by the contract or option to acquire) is less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(c) If the amount of stock or securities acquired (or covered by the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility of the loss shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.118–1 *Losses from wash sales of stock or securities.* (a) A taxpayer cannot deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities, if, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date (referred to in this section as the 61-day period), he has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially indentical stock or securities. However, this prohibition does not apply (1) in the case of a taxpayer, not a corporation, if the sale or other disposition of stock or se-

curities is made in connection with the taxpayer's trade or business, or (2) in the case of a corporation, a dealer in stock or securities, if the sale or other disposition of stock or securities is made in the ordinary course of its business as such dealer. See § 29.22 (a)–8 as to stock or securities sold from lots purchased at different dates or at different prices where the identity of the lots cannot be determined and § 29.113 (a) (10)–1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

(b) Where more than one loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities, the provisions of this section shall be applied to the losses in the order in which the stock or securities the disposition of which resulted in the respective losses were disposed of (beginning with the earliest disposition). If the order of disposition of stock or securities disposed of at a loss on the same day cannot be determined, the stock or securities will be considered to have been disposed of in the order in which they were originally acquired (beginning with the earliest acquisition).

(c) Where the amount of stock or securities acquired within the 61-day period is less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be those with which the stock or securities acquired are matched in accordance with the following rule:

The stock or securities acquired will be matched in accordance with the order of their acquisition (beginning with the earliest acquisition) with an equal number of the shares of stock or securities sold or otherwise disposed of.

(d) Where the amount of stock or securities acquired within the 61-day period is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which resulted in the nondeductibility of the loss shall be those with which the stock or securities disposed of are matched in accordance with the following rule:

The stock or securities sold or otherwise disposed of will be matched with an equal number of the shares of stock or securities acquired in accordance with the order of acquisition (beginning with the earliest acquisiton) of the stock or securties acquired.

(e) The acquisition of any share of stock or any security which results in the nondeductibility of a loss under the provisions of this section shall be disregarded in determining the deductibility of any other loss.

(f) The word "acquired" as used in this section means acquired by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law, and comprehends cases where the taxpayer has entered into a contract or option within the 61-day period to acquire by purchase or by such an exchange.

Example (1). A, whose taxable year is the calendar year, on December 1, 1941, purchased 100 shares of common stock in the M Company for $10,000 and on December 15, 1941, purchased 100 additional shares for $9,000. On January 2, 1942, he sold the 100 shares purchased on December 1, 1941, for $9,000. Because of the provisions of section 118 no loss from the sale is allowable as a deduction.

Example (2). A, whose taxable year is the calendar year, on September 21, 1941, purchased 100 shares of the common stock of the M Company for $5,000. On December 21, 1941, he purchased 50 shares of substantially identical stock for $2,750, and on December 26, 1941, he purchased 25 additional shares of such stock for $1,125. On January 2, 1942, he sold for $4,000 the 100 shares purchased on September 21, 1941. There is an indicated loss of $1,000 on the sale of the 100 shares. Since within the 61-day period A purchased 75 shares of substantially identical stock, the loss on the sale of 75 of the shares ($3,750—$3,000, or $750) is not allowable as a deduction because of the provisions of section 118. The loss on the sale of the remaining 25 shares ($1,250—$1,000, or $250) is deductible subject to the limitations provided in sections 24 (b) and 117. The basis of the 50 shares purchased December 21, 1941, the acquisition of which resulted in the nondeductibility of the loss ($500) sustained on 50 of the 100 shares sold on January 2, 1942, is $2,500 (the cost of 50 of the shares sold on January 2, 1942), plus $750 (the difference between the purchase price of the 50 shares acquired on December 21, 1941 ($2,750), and the selling price of 50 of the shares sold on January 2, 1942 ($2,000)), or $3,250. Similarly the basis of the 25 shares purchased on December 26, 1941, the acquisition of which resulted in the nondeductibility of the loss ($250) sustained on 25 of the shares sold on January 2, 1942, is $1,250 plus $125, or $1,375. (See § 29.113 (a) (10)–1.)

Example (3). A, whose taxable year is the calendar year, on September 15, 1940, purchased 100 shares of the stock of the M Company for $5,000. He sold these shares on February 1, 1942, for $4,000. On each of the four days from February 15, 1942, to February 18, 1942, he purchased 50 shares of substantially identical stock for $2,000. There is an indicated loss of $1,000 from the sale of the 100 shares on February 1, 1942, but, since within the 61-day period A purchased not less than 100 shares of substantially identical stock, the loss is not deductible. The particular shares of stock the purchase of which resulted in the nondeductibility of the loss are the first 100 shares purchased within such period, that is, the 50 shares purchased on February 15, 1942, and the 50 shares purchased on February 16, 1942. In determining the period for which the 50 shares purchased on February 15, 1942, and the 50 shares purchased on February 16, 1942, were held, there is to be included the period for which the 100 shares purchased on September 15, 1940, and sold on February 1, 1942, were held.

SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES [as amended by sec. 160 (c), Rev. Act 1942]. (a) *Gross income from sources in United States.* The following items of gross income shall be treated as income from sources within the United States:

(1) *Interest.* Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—

(A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States, or

(B) interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per centum of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the provisions of this section for the three-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of such period as may be applicable, or

(C) income derived by a foreign central bank of issue from bankers' acceptances;

(2) *Dividends.*—The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 251, and other than a corporation less than 20 per centum of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or

(B) from a foreign corporation unless less than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of this section; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period derived from sources within the United States bears to its gross income from all sources; but dividends from a foreign corporation shall, for the purposes of section 131 (relating to foreign tax credit), be treated as income from sources without the United States;

(3) *Personal services.* Compensation for labor or personal services performed in the United States, but in the case of a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year, compensation received by such an individual (if such compensation does not exceed $3,000 in the aggregate) for labor or services performed as an employee of or under a contract with a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, shall not be deemed to be income from sources within the United States;

(4) *Rentals and royalties.* Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

(5) *Sale of real property.* Gains, profits, and income from the sale of real property located in the United States.

(6) *Sale of personal property.* For gains, profits, and income from the sale of personal property, see subsection (e).

(b) *Net income from sources in United States.* From the items of gross income specified in subsection (a) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States.

(c) *Gross income from sources without United States.* The following items of gross income shall be treated as income from sources without the United States:

(1) Interest other than that derived from sources within the United States as provided in subsection (a) (1) of this section;

(2) Dividends other than those derived from sources within the United States as provided in subsection (a) (2) of this section;

(3) Compensation for labor or personal services performed without the United States;

(4) Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties; and

(5) Gains, profits, and income from the sale of real property located without the United States.

(d) *Net income from sources without United States.* From the items of gross income specified in subsection (c) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as net income from sources without the United States.

(e) *Income from sources partly within and partly without United States.* Items of gross income, expenses, losses and deductions, other than those specified in subsections (a) and (c) of this section, shall be allocated or apportioned to sources within or without the United States, under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the net income therefrom) the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States. In the case of gross income derived from sources partly within and partly without the United States, the net income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some items or class of gross income; and the portion of such net income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Commissioner with the approval of the Secretary. Gains, profits and income from—

(1) transportation or other services rendered partly within and partly without the United States, or

(2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States.

shall be treated as derived partly from sources within and partly from sources without the United States. Gains, profits and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from sources within the country in which sold, except that gains, profits, and income derived from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States.

(f) *Definitions.* As used in this section the words "sale" or "sold" include "exchange" or "exchanged"; and the word "produced" includes "created", "fabricated", "manufactured", "extracted", "processed", "cured", or "aged".

§ 29.119–1 *Income from sources within the United States.* Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251 are taxable only upon income from sources within the United States. Citizens of the United States and domestic corporations entitled to the benefits of section 251 are, however, taxable upon income received within the United States, whether derived from sources within or without the United States. (See sections 212 (a), 231 (c), and 251.)

The Internal Revenue Code divides the income of such taxpayers into three classes:

(a) Income which is derived in full from sources within the United States;

(b) Income which is derived in full from sources without the United States; and

(c) Income which is derived partly from sources within and partly from sources without the United States.

The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States.

§ 29.119–2 *Interest.* There shall be included in the gross income from sources within the United States, of nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations which are entitled to the benefits of section 251, all interest received or accrued, as the case may be, from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except:

(a) Interest paid on deposits with persons, including individuals, partnerships, or corporations, carrying on the banking business, to persons (nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251) not engaged in business within the United States;

(b) Interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 percent of the gross income of such resident payor or domestic corporation has been derived from sources within the United States (as determined under the provisions of section 119) for the 3-year period ending with the close of the taxable year of the payor which precedes the payment of such interest, or for such part of that period as may be applicable; and

(c) Income derived by a foreign central bank of issue from bankers' acceptances. A foreign central bank of issue means a bank which is by law or government sanction the principal authority (other than the government itself) issuing instruments intended to circulate as currency. Such banks are generally the custodians of the banking reserves of their countries.

Any taxpayer who excludes from gross income from sources within the United States income of the type specified in paragraph (a), (b), or (c) of this section shall file with his return a statement setting forth the amount of such income and such information as may be necessary to show that the income is of the type specified in those paragraphs.

Interest received from the United States by a foreign corporation or a nonresident alien on a refund of Federal income taxes is taxable as income from sources within the United States.

As to the inclusion in gross income of items received in the United States even though representing income from sources without the United States, in the case of citizens of the United States and domestic corporations entitled to the benefits of section 251, see § 29.251–2.

§ 29.119–3 *Dividends.* Gross income from sources within the United States includes dividends, as defined by section 115:

(a) From a domestic corporation other than one entitled to the benefits of section 251, and other than a corporation less than 20 percent of the gross income of which is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of section 119, for the 3-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence); or

(b) From a foreign corporation unless the 50 percent of its gross income for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends, or for such part of such period as it has been in existence, was derived from sources within the United States; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period derived from sources within the United States bears to its gross income from all sources. However, for the purposes of section 131, relating to credits for taxes of foreign countries and possessions of the United States, dividends from a foreign corporation shall be treated as income from sources without the United States.

Dividends will be treated as income from sources within the United States (except for the purposes of section 131) unless the taxpayer submits sufficient data to establish to the satisfaction of the Commissioner that they should be excluded from gross income under para-

graph (a) or (b) of this section. (See also section 116 (f).)

§ 29.119–4 *Compensation for labor or personal services.* Except as provided in section 119 (a) (3), gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for service was made, or of the place of payment. If a specific amount is paid for labor or personal services performed in the United States, such amount (if income from sources within the United States) shall be included in the gross income. If no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis, i. e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made. Except as provided in section 119 (a) (3), wages received for services rendered inside the territorial limits of the United States and wages of an alien seaman earned on a coastwise vessel are to be regarded as from sources within the United States.

§ 29.119–5 *Rentals and royalties.* Gross income from sources within the United States includes rentals or royalties from property located within the United States or from any interest in such property, including rentals or royalties for the use of or the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. The income arising from the rental of property, whether tangible or intangible, located within the United States, or from the use of property, whether tangible or intangible, within the United States, is from sources within the United States.

§ 29.119–6 *Sale of real property.* Gross income from sources within the United States includes gain, computed under the provisions of sections 111 to 113, inclusive, derived from the sale or other disposition of real property located in the United States. For the treatment of capital gains and losses, see section 117.

§ 29.119–7 *Income from sources without the United States.* Gross income from sources without the United States includes:

(a) Interest other than that specified in section 119 (a) (1), as being derived from sources within the United States;

(b) Dividends other than those derived from sources within the United States as provided in section 119 (a) (2);

(c) Compensation for labor or personal services performed without the United States (for the treatment of compensation for labor or personal services performed partly within the United States and partly without the United States, see § 29.119–4);

(d) Rentals or royalties derived from property without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property (see § 29.119–5); and

(e) Gain derived from the sale of real property located without the United States (see sections 111 to 113, inclusive).

§ 29.119–8 *Sale of personal property.* Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold, except that income derived from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States. A possession of the United States constitutes a "country," within the meaning of this section, separate and distinct from the United States. Hence income derived from the purchase of personal property within the United States and its sale within a possession of the United States shall be treated as derived entirely from within a possession of the United States. The word "sold" includes "exchanged." The "country in which sold" ordinarily means the place where the property is marketed. This section does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. (See § 29.119–12.)

§ 29.119–9 *Deductions in general.* The deductions provided for in chapter 1 shall be allowed to nonresident alien individuals and foreign corporations engaged in trade or business within the United States, and to citizens of the United States and domestic corporations entitled to the benefits of section 251, only if and to the extent provided in sections 213, 215, 232, 233, and 251.

§ 29.119–10 *Apportionment of deductions.* From the items specified in §§ 29.119–1 to 29.119–6, inclusive, as being derived specifically from sources within the United States there shall, in the case of nonresident alien individuals and foreign corporations engaged in trade or business within the United States, be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which cannot definitely be allocated to some item or class of gross income. The remainder shall be included in full as net income from sources within the United States. The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income.

Example. A nonresident alien individual engaged in trade or business within the United States whose taxable year is the calendar year derived gross income from all sources for 1942 of $180,000, including therein:

Interest on bonds of a domestic corporation	$9,000
Dividends on stock of a domestic corporation	4,000
Royalty for the use of patents within the United States	12,000
Gain from sale of real property located within the United States	11,000
Total	36,000

that is, one-fifth of the total gross income was from sources within the United States. The remainder of the gross income was from sources without the United States, determined under § 29.119–7.

The expenses of the taxpayer for the year amounted to $78,000. Of these expenses the amount of $8,000 is properly allocated to income from sources within the United States and the amount of $40,000 is properly allocated to income from sources without the United States.

The remainder of the expenses, $30,000, cannot be definitely allocated to any class of income. A ratable part thereof, based upon the relation of gross income from sources within the United States to the total gross income, shall be deducted in computing net income from sources within the United States. Thus, there are deducted from the $36,000 of gross income from sources within the United States expenses amounting to $14,000 (representing $8,000 properly apportioned to the income from sources within the United States and $6,000, a ratable part (one-fifth) of the expenses which could not be allocated to any item or class of gross income). The remainder, $22,000, is the net income from sources within the United States.

§ 29.119–11 *Other income from sources within the United States.* Items of gross income other than those specified in section 119 (a) and (c) shall be allocated or apportioned to sources within or without the United States, as provided in section 119 (e).

The income derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located within the United States, and from the sale by the producer of the products thereof within or without the United States, shall ordinarily be included in gross income from sources within the United States. If however, it is shown to the satisfaction of the Commissioner that due to the peculiar conditions of production and sale in a specific case or for other reasons all of such gross income should not be allocated to sources within the United States, an apportionment thereof to sources within the United States and to sources without the United States shall be made as provided in § 29.119–12.

Where items of gross income are separately allocated to sources within the United States, there shall be deducted therefrom, in computing net income, the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income.

§ 29.119–12 *Income from the sale of personal property derived from sources*

partly within and partly without the United States. Items of gross income not allocated by § 29.119–1 to 29.119–8, inclusive, or § 29.119–11, to sources within or without the United States shall (unless unmistakably from a source within or a source without the United States) be treated as derived from sources partly within and partly without the United States. Such income derived from the sale of personal property may be divided into two classes: (a) Income derived from sources partly within the United States and partly within a foreign country, and (b) income derived from sources partly within the United States and partly within a possession of the United States.

(a) The portion of such income derived from sources partly within the United States and partly within a foreign country which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold. Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country, or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States shall be treated as derived partly from sources within the United States and partly from sources within a foreign country under one of the cases set forth below. As used herein the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1 A. Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling concerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise established — unaffected by considerations of tax liability, and the selling or distributing branch or department of the business is located in a different country from that in which the factory is located or the production carried on, the net income attributable to sources within the United States shall be computed by an accounting which treats the products as sold by the factory or productive department of the business to the distributing or selling department at the independent factory price so established. In all cases the basis of the accounting shall be fully explained in a statement attached to the return.

Case 2 A. Where an independent factory or production price has not been established as provided under Case 1 A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States, and the denominator of which consists of the value of the taxpayer's property both within the United States and within the foreign country. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the United States, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within the United States and within the foreign country. The term "gross sales of the taxpayer within the United States" means the gross sales made during the taxable year which were principally secured, negotiated, or effected by employees, agents, offices, or branches of the taxpayer's business resident or located in the United States. The term "gross sales" as used in this paragraph refers only to the sales of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, and the term "property" includes only the property held or used to produce income which is derived from such sales. Such property should be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes of taxation shall be the highest amount at which so valued or appraised, and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch, or agent in the United States.

Case 3 A. Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the processes or formulas herein prescribed, the income derived from sources within the United States.

(b) The portion of such income derived from sources partly within the United States and partly within a possession of the United States which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold. Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a possession of the United States, or produced (in whole or in part) by the taxpayer within a possession of the United States and sold within the United States shall be treated as derived partly from sources within the United States and partly from sources within a possession of the United States under one of the cases set forth below. As used herein the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1 B. Same as case 1 A.

Case 2 B. Where an independent factory or production price has not been established as provided under case 1 A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a possession of the United States, or produced (in whole or in part) by the taxpayer within a possession of the United States and sold within the United States, the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within the United States and within the possession of the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States, and the denominator of which consists of the value of the taxpayer's property both within the United States and within the possession of the United States. The remaining one-half of such net income shall be apportioned in accordance with the total business of the taxpayer within the United States and within the possession of the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the amount of the taxpayer's business for the taxable year or period within the United States, and the de-

nominator of which consists of the amount of the taxpayer's business for the taxable year or period both within the United States and within the possession of the United States. The "business of the taxpayer" as that term is used in this paragraph shall be measured by the amounts which the taxpayer paid out during the taxable year or period for wages, salaries, and other compensation of employees and for the purchase of goods, materials, and supplies consumed in the regular course of business, plus the amounts received during the taxable year or period from gross sales, such expenses, purchases, and gross sales being limited to those attributable to the production (in whole or in part) of personal property within the United States and its sale within a possession of the United States or to the production (in whole or in part) of personal property within a possession of the United States and its sale within the United States. The term "property" as used in this paragraph includes only the property held or used to produce income which is derived from such sales.

Case 3 B. Same as case 3 A.

Personal property purchased and sold. Gross income derived from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within the United States and partly from sources within a possession of the United States under one of the following cases:

Case I B. The net income shall first be computed by deducting from such gross income the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The amount of net income so determined shall be apportioned in accordance with the total business of the taxpayer within the United States and within the possession of the United States, the portion attributable to sources within the United States being that percentage of such net income which the amount of the taxpayer's business for the taxable year or period within the United States bears to the amount of the taxpayer's business for the taxable year or period both within the United States and within the possession of the United States. The "business of the taxpayer" as that term is used in this paragraph shall be measured by the amounts which the taxpayer paid out during the taxable year or period for wages, salaries, and other compensation of employees and for the purchase of goods, materials, and supplies sold or consumed in the regular course of business, plus the amount received during the taxable year or period from gross sales, such expenses, purchases, and gross sales being limited to those attributable to the purchase of personal property within a possession of the United States and its sale within the United States.

Case II B. Same as case 3 A.

§ 29.119–13 *Transportation service.* A foreign corporation carrying on the business of transportation service between points in the United States and points outside the United States derives income partly from sources within and partly from sources without the United States.

(a) The gross income from sources within the United States derived from such services shall be determined by taking such a portion of the total gross revenues therefrom as (1) the sum of the costs or expenses of such transportation business carried on by the taxpayer within the United States and a reasonable return upon the property used in its transportation business while within the United States bears to (2) the sum of the total costs or expenses of such transportation business carried on by the taxpayer and a reasonable return upon the total property used in such transportation business. Revenues from operations incidental to transportation services (such as the sale of money orders) shall be apportioned on the same basis as direct revenues from transportation services.

In allocating the total costs or expenses incurred in such transportation business, costs or expenses incurred in connection with that part of the services which was wholly rendered in the United States should be assigned to the cost of transportation business within the United States. For example, expenses of loading and unloading in the United States, rentals, office expenses, salaries, and wages wholly incurred for services rendered to the taxpayer in the United States belong to this class. Costs and expenses incurred in connection with services rendered partly within and partly without the United States may be prorated on a reasonable basis between such services. For example, ship wages, charter money, insurance, and supplies chargeable to voyage expenses should ordinarily be prorated for each voyage on the basis of the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days on the voyage, and fuel consumed on each voyage may be prorated on the basis of the proportion which the number of miles sailed within the territorial limits of the United States bears to the total number of miles sailed on the voyage. Income, war-profits, and excess-profits taxes should not be regarded as costs or expenses for the purpose of determining the proportion of gross income from sources within the United States; and for such purpose, interest and other expenses for the use of borrowed capital should not be taken into the cost of services rendered, for the reason that the return upon the property used measures the extent to which such borrowed capital is the source of the income. For other expenses entering into the cost of services, only such expenses as are allowable deductions under the Internal Revenue Code should be taken.

The value of the property used should be determined upon the basis of cost less depreciation. Eight percent may ordinarily be taken as a reasonable rate of return to apply to such property. The property taken should be the average property employed in the transportation service between points in the United States and points outside the United States during the taxable year. Current assets should be decreased by current liabilities and allocated to services between the United States and foreign countries and to other services. The part allocated to services between the United States and foreign countries should be based on the proportion which the gross receipts from such services bear to the gross receipts from all services. The amount so allocated to services between the United States and foreign countries should be further allocated to services rendered within the United States and to services rendered without the United States. The portion allocable to services rendered within the United States should be based on the proportion which the expenses incurred within the territorial limits of the United States bear to the total expenses incurred in services between the United States and foreign countries. For ships the average should be determined upon a daily basis for each ship and the amount to be apportioned for each ship as assets employed within the United States should be computed upon the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days the ship was in service during the taxable period. For other assets employed in the transportation business, the average of the assets at the beginning and end of the taxable period ordinarily may be taken, but if the average so obtained does not, by reason of material changes during the taxable year, fairly represent the average for such year either for the assets employed in the transportation ousiness in the United States or in total, the average must be determined upon a monthly or daily basis.

(b) In computing net income from sources within the United States there shall be allowed as deductions from the gross income as determined in accordance with paragraph (a), (1) the expenses of the transportation business carried on within the United States as determined under paragraph (a), and (2) the expenses determined in accordance with paragraphs (c) and (d).

(c) Interest and income, war-profits, and excess-profits taxes should be excluded from the apportionment process, as explained in paragraph (a); but for the purpose of computing net income there may be deducted from the gross income from sources within the United States, after the amount of such gross income has been determined, a ratable part (1) of all interest (deductible under section 23 (b)), and (2) of all income, war-profits, and excess-profits taxes (deductible under section 23 (c) and (d)), paid or accrued in respect of the business of transportation service between points in the United States and points outside the United States. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income from such transportation service.

(d) If a foreign corporation subject to this section is also engaged in a business other than that of providing transportation service between points in the

United States and points outside the United States, the costs and expenses (including taxes) properly apportioned or allocated to such other business should be excluded both from the deductions and from the apportionment process prescribed in paragraph (a); but, for the purpose of determining net income, a ratable part of any general expenses, losses, or deductions, which cannot definitely be allocated to some item or class of gross income, may be deducted from the gross income from sources within the United States after the amount of such gross income has been determined. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income.

(e) Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer subject to this section, who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the process prescribed in paragraphs (a) to (d), inclusive, the income derived from sources within the United States.

§ 29.119–14 *Telegraph and cable service.* A foreign corporation carrying on the business of transmission of telegraph or cable messages between points in the United States and points outside the United States derives income partly from sources within and partly from sources without the United States.

(a) *Gross income.* The gross income from sources within the United States derived from such services shall be determined by adding (1) its gross revenues derived from messages originating in the United States and (2) amounts collected abroad on collect messages originating in the United States and deducting from such sum amounts paid or accrued for transmission of messages beyond the company's own circuit. Amounts received by the company in the United States with respect to collect messages originating without the United States shall be excluded from gross income.

(b) *Net income.* In computing net income from sources within the United States there shall be allowed as deductions from gross income determined in accordance with paragraph (a), (1) all expenses incurred in the United States (not including any general overhead expenses) incident to the carrying on of the business in the United States, (2) all direct expenses incurred abroad in the transmission of messages originating in the United States (not including any general overhead expenses or maintenance, repairs, and depreciation of cables not including any amount already deducted in computing gross income), (3) depreciation of property (other than cables) located in the United States and used in the trade or busines therein, and (4) a proportionate part of the general overhead expenses (not including any items incurred abroad corresponding to those enumerated in (1), (2), and (3)) and of maintenance, repairs, and depreciation of cables of the entire cable system of the enterprise based on the ratio which the number of words originating in the United States bears to the total words transmitted by the enterprise.

§ 29.119–15 *Computation of income.* If a taxpayer has gross income from sources within or without the United States as defined by section 119 (a) or (c) together with gross income derived partly from sources within and partly from sources without the United States, the amounts thereof, together with the expenses and investment applicable thereto, shall be segregated, and the net income from sources within the United States shall be separately computed therefrom.

SEC. 120. UNLIMITED DEDUCTION FOR CHARITABLE AND OTHER CONTRIBUTIONS.

In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 23 (o) (or corresponding provisions of prior revenue Acts) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 15 per centum limit imposed by section 23 (o) shall not be applicable.

§ 29.120–1 *Unlimited deduction for charitable and other contributions.* Under the circumstances specified in section 120, the 15 percent limitation imposed by section 23 (o) on the deduction for charitable and other contributions is not applicable.

In the case of a husband and wife making a joint return for any taxable year, the 15 percent limitation on the deduction for contributions or gifts imposed by section 23 (o) shall not be applicable if the aggregate amount of the contributions or gifts described in section 23 (o) (or corresponding provisions of prior Revenue Acts) made by the spouses in the taxable year and in each of the 10 preceding years, plus the aggregate amount of income, war-profits, or excess-profits taxes paid by the spouses during such year in respect of preceding taxable years, exceeds 90 percent of the aggregate net income of the spouses for each such year, as computed without the benefit of any deduction for contributions or gifts.

SEC. 121. DEDUCTION OF DIVIDENDS PAID ON CERTAIN PREFERRED STOCK OF CERTAIN CORPORATIONS.

In computing the net income of any national banking association, or of any bank or trust company organized under the laws of any State, Territory, possession of the United States, or the Canal Zone, or of any other banking corporation engaged in the business of industrial banking and under the supervision of a State banking department or of the Comptroller of the Currency, or of any incorporated domestic insurance company, there shall be allowed as a deduction from gross income, in addition to deductions otherwise provided for in this chapter, any dividend (not including any distribution in liquidation) paid, within the taxable year, to the United States or to any instrumentality thereof exempt from Federal income taxes, on the preferred stock of the corporation owned by the United States or such instrumentality. The amount allowable as a deduction under this section shall be deducted from the basic surtax credit otherwise computed under section 27 (b).

SEC. 122. NET OPERATING LOSS DEDUCTION [as added by sec. 211 (b), Rev. Act 1939, and amended by secs. 105 (e), 150 (e), 153 (a) (b) (c), Rev. Act 1942].

(a) *Definition of net operating loss.* As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of carry-back and carry-over*—(1) *Net operating loss carry-back.* If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) *Net operating loss carry-over.* If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(c) *Amount of net operating loss deduction.* The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)), exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26 (e)).

(d) *Exceptions and limitations.* The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred

or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117 (b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains;

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustment provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

(e) *No carry-back to year prior to 1941.* As used in this section, the term "preceding taxable year" and the term "preceding taxable years" do not include any taxable year beginning prior to January 1, 1941.

§ 29.122–1 *Net operating loss deduction*—(a) *General.* Section 122 provides the rules for the computation of the net operating loss deduction allowed by section 23 (s). The net operating loss deduction is the aggregate of the net operating loss carry-overs and carry-backs to the taxable year, reduced by certain adjustments to prevent the deduction of losses absorbed by income not taxed.

Section 122 provides that the aggregate of the net operating loss carry-overs and carry-backs to a taxable year shall be the basis of the net operating loss deduction. For the purpose of determining such carry-overs, the net operating loss for any taxable year may be carried over to the two succeeding taxable years. If the taxable year began on or after January 1, 1942, the net operating loss for such taxable year may also be carried back to the two preceding taxable years, not considering as a preceding taxable year any year which began before January 1, 1941. The amount of the net operating loss which may be carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed by the net income for the other taxable years, preceding such taxable year, to which it was carried back or carried over. If the net operating losses for several taxable years are carried back or carried over to one taxable year, they are considered to be applied in reduction of the net income for such taxable year in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year. Therefore, the net operating loss carry-overs to a taxable year beginning on or after January 1, 1942, are the net operating loss for the first preceding taxable year and so much of the net operating loss for the second preceding taxable year as has not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year, and the net operating loss carry-backs to such a taxable year are the net operating loss for the second succeeding taxable year and so much of the net operating loss for the first succeeding taxable year as has not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year. If either of the taxable years preceding the taxable year for which the deduction is allowed began on or after January 1, 1942, the net operating loss for such preceding taxable year is first reduced to the extent it has been absorbed by the net income (computed under section 122), if any, for the taxable years to which such loss has been carried back.

A fractional part of a year which is a taxable year under section 48 (a) is a preceding or succeeding taxable year for the purpose of determining under section 122 the first, second, or third preceding taxable year or the first or second succeeding taxable year.

Every taxpayer claiming a net operating loss deduction for any taxable year shall file with his return for such year a concise statement setting forth the amount of the net operating loss deduction claimed and all material and pertinent facts relative thereto, including a detailed schedule showing the computation of the net operating loss deduction.

(b) *Steps in computation of net operating loss deduction.* There are three steps in the ascertainment of the net operating loss deduction. The first step is the computation of the net operating loss, if any, for the two preceding taxable years and for the two succeeding taxable years. The second is the computation of the net operating loss carry-overs to the taxable year from such preceding taxable years and the computation of the net operating loss carry-backs to the taxable year from such succeeding taxable years. The third is the conversion of the aggregate of such net operating loss carry-overs and carry-backs into the net operating loss deduction.

(c) *Ascertainment of deduction dependent upon net operating loss carry-back.* If the taxpayer is entitled in computing his net operating loss deduction to a carry-back which he is not able to ascertain at the time his return is due, he shall compute the net operating loss deduction on the return without regard to such net operating loss carry-back. When the taxpayer ascertains the net operating loss carry-back, he may within the applicable period of limitations file a claim for credit or refund of the overpayment, if any, resulting from the failure to compute the net operating loss deduction for the taxable year with the inclusion of such carry-back. Under the provisions of section 3771 (e), no interest is allowed with respect to any such overpayment for the period prior to the filing of the claim for credit or refund of such overpayment or prior to the filing of a petition with The Tax Court of the United States asserting such overpayment, whichever is earlier. If the taxpayer files a claim based upon the overpayment caused by a carry-back from the first succeeding taxable year, and later ascertains that he is entitled to a carry-back from the second succeeding taxable year, he should file a second claim for credit or refund based on the overpayment, if any, caused by the failure to take into account the carry-back from such second succeeding taxable year.

§ 29.122–2 *Computation of net operating loss in case of corporation.* A net operating loss is sustained by a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over gross income, both computed with the following exceptions, additions, and limitations:

(a) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(b) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by chapter 1, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(c) No net operating loss deduction shall be allowed;

(d) For any taxable year beginning after December 31, 1938, and before January 1, 1942, the amount deductible on account of long-term capital losses shall not exceed the amount includible on account of long-term capital gains, and the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of short-term capital gains. For any taxable year beginning after December 31, 1941, the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of such assets; and

(e) For taxable years beginning after December 31, 1941, there shall be allowed as a deduction the amount of excess profits tax imposed by subchapter E of chapter 2 paid or accrued within the taxable year, subject, however, to the provisions of section 122 (d) (6) (A), (B), and (C).

The application of this section may be illustrated by the following example:

Example. For the year 1942 the X Corporation, which makes its income tax returns on the calendar year basis, has gross income as defined in section 22 of $400,000 and deductions allowed by section 23 of $600,000, exclusive of any net operating loss deduction. Included in gross income are long-term capital gains of $50,000 and short-term capital gains of $25,000. The corporation had long-term capital losses of $60,000 and short-term capital losses of $35,000, which are deductible to the extent of the capital gains, or $75,000. The X Corporation also deducted $75,000 for

depletion on a percentage basis. If depletion had been computed without reference to percentage depletion, the amount of such deduction would have been $5,000. For 1942 the X Corporation also had $35,000 of wholly tax-exempt interest, and paid $15,000 in interest on indebtedness incurred to carry the obligations from which such tax-exempt interest was derived.

On the basis of these facts the X Corporation has a net operating loss for the year 1942 of $110,000, computed as follows:

(1) Deductions for 1942		$600,000
Less:		
(2) Excess of percentage depletion over cost ($75,000 minus $5,000)		70,000
(3) Deductions adjusted as required by section 122 (d) (item (1) minus item (2))		530,000
(4) Gross income for 1942	$400,000	
(5) Plus tax-exempt interest minus interest paid ($35,000 minus $15,000)	20,000	
(6) Gross income adjusted as required by section 122 (d) (item (4) plus item (5))		420,000
(7) Net operating loss for 1942 (item (3) minus item (6))		110,000

§ 29.122–3 *Computation of net operating loss in case of a taxpayer other than a corporation*—(a) *General.* A net operating loss is sustained by a taxpayer other than a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over gross income, both computed with the following exceptions and limitations:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by chapter 1, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) Long-term capital gains and long-term capital losses shall be taken into account without regard to the percentage provisions of section 117 (b);

(5) For any taxable year beginning after December 31, 1938, and before January 1, 1942, the amount deductible on account of business long-term and short-term capital losses shall not exceed the amount includible on account of the business long-term and short-term capital gains, respectively, plus an allocable portion of any nonbusiness long-term and short-term capital gains, computed in accordance with paragraph (c) of this section; and for any taxable year beginning after December 31, 1941, the amount deductible on account of business capital losses shall not exceed the amount includible on account of business capital gains, plus a portion of any nonbusiness capital gains, computed in accordance with paragraph (c) of this section;

(6) For any taxable year beginning after December 31, 1938, and before January 1, 1942, the amount deductible on account of nonbusiness long-term and short-term capital losses shall not exceed the amount includible on account of nonbusiness long-term and short-term capital gains, respectively, and for any taxable year beginning after December 31, 1941, the amount deductible on account of nonbusiness capital losses shall not exceed the amount includible on account of nonbusiness capital gains; and

(7) Ordinary nonbusiness deductions (i. e., exclusive of capital losses) shall be allowed only to the extent of the amount of ordinary nonbusiness gross income (i. e., exclusive of capital gains), plus (i) for any taxable year beginning after December 31, 1938, and before January 1, 1942, the excess, if any, of nonbusiness long-term and short-term capital gains over nonbusiness long-term and short-term capital losses, respectively, and (ii) for any taxable year beginning after December 31, 1941, the excess, if any, of nonbusiness capital gains over nonbusiness capital losses.

(b) *Treatment of carry-overs*—(1) *Taxable years beginning before 1943.* Because of the distinction between business and nonbusiness capital gains and losses, a taxpayer who has, for any taxable year beginning after December 31, 1938, and before January 1, 1943, a net short-term capital loss carry-over from the preceding taxable year, includible among his short-term capital losses for the current taxable year by virtue of section 117 (e), must determine how much of such net short-term capital loss carry-over is a business and how much is a nonbusiness short-term capital loss. In order to make this determination, the taxpayer must first ascertain what proportion of the net short-term capital loss for the preceding taxable year was attributable to an excess of business short-term capital losses over business short-term capital gains for such year, and what proportion was attributable to an excess of nonbusiness short-term capital losses over nonbusiness short-term capital gains. The same proportions of the net short-term capital loss carry-over from such preceding taxable year shall be treated as a business short-term capital loss and a nonbusiness short-term capital loss, respectively.

This rule may be illustrated by the following examples:

Example (1). Without considering any short-term capital loss carry-over to the taxable year 1941. A, an individual, has the following short-term capital gains and losses for such taxable year:

Business short-term capital gains of $1,000 and nonbusiness short-term capital gains of $500, business short-term capital losses of $1,600 and nonbusiness short-term capital losses of $600. A's net short-term capital loss for the taxable year 1941 is $700, computed as follows:

Short-term capital losses ($1,600 plus $600)		$2,200
Less: Short-term capital gains ($1,000 plus $500)		1,500
Net short-term capital loss for 1941		700

Since the business short-term capital losses exceeded the business short-term capital gains by $600 ($1,600 minus $1,000), $600 of the $700 net short-term capital loss is attributable to such excess. Similarly, $100 is attributable to an excess of nonbusiness short-term capital losses over nonbusiness short-term capital gains. Assuming that the net short-term capital loss carry-over to 1942 from 1941 is also $700, then the same amounts will be treated as business and nonbusiness short-term capital losses, respectively, i. e., $600 will be treated as a business short-term capital loss and $100 as a nonbusiness short-term capital loss.

Example (2) Assume the same facts as in the previous example except that the net short-term capital loss carry-over to 1942 from 1941 is only $350, because of the limitations contained in section 117 (e). Since six-sevenths ($600) of the $700 net short-term capital loss for 1941 was attributable to an excess of business short-term capital losses over gains and one-seventh ($100) was attributable to an excess of nonbusiness short-term capital losses over gains, six-sevenths, or $300, of the $350 short-term capital loss carry-over from 1941 to 1942 shall be treated as a business short-term capital loss, and one-seventh, or $50, shall be treated as a nonbusiness short-term capital loss.

(2) *Taxable years beginning after December 31, 1942.* Because of the distinction between business and nonbusiness capital gains and losses, a taxpayer who has, for any taxable year beginning after December 31, 1942, a net capital loss carry-over from preceding taxable years, includible among the short-term capital losses for the current taxable year by virtue of section 117 (e), must determine how much of such net capital loss carry-over is a business capital loss and how much is a nonbusiness capital loss. In order to make this determination, the taxpayer must first ascertain what proportion of the net capital losses for such preceding taxable years was attributable to an excess of business capital losses over business capital gains for such years, and what proportion was attributable to an excess of nonbusiness capital losses over nonbusiness capital gains. The same proportion of the net capital loss carry-over from any such preceding taxable years shall be treated as a business capital loss and a nonbusiness capital loss, respectively.

The effect of this subparagraph may be illustrated by the following example:

Example. A, an individual, has the following short-term gains and losses for the calendar year 1943: Business short-term capital gains of $1,000 and nonbusiness short-term capital gains of $500, business short-term capital losses of $1,600 and nonbusiness short-term capital losses of $600, business long-term capital gains of $1,000 and nonbusiness long-term capital gains of $500, business long-term capital losses of $1,600 and nonbusiness long-term capital losses of $600. A's net capital loss for the taxable year 1943 is $1,400, computed as follows:

Short-term capital losses ($1,600 plus $600)		$2,200
Long-term capital losses ($1,600 plus $600)		2,200
Total capital losses		4,400
Short-term capital gains ($1,000 plus $500)	1,500	
Long-term capital gains ($1,000 plus $500)	1,500	
Total capital gains		3,000
Net capital loss for 1943		1,400

since business capital losses exceeded business capital gains by $1,200 ($3,200 minus $2,000), $1,200 of the $1,400 net capital loss is attributable to such excess. Similarly, $200 is attributable to an excess of nonbusiness capital losses over nonbusiness capital gains. Assuming that the net capital loss carry-over to 1944 from 1943 is also $1,400, then the same amounts will be treated as business and nonbusiness capital losses, respectively, i. e., $1,200 will be treated as a business capital loss and $200 as a nonbusiness capital loss.

(c) *Determination of portion of nonbusiness capital gains available for the deduction of business capital losses*—(1) *Taxable years beginning before 1942.* In the computation of a net operating loss a taxpayer other than a corporation must, for taxable years beginning after December 31, 1938, and before January 1, 1942, first use his nonbusiness long-term and short-term capital gains for the deduction of his nonbusiness long-term and short-term capital losses, respectively. See paragraph (a) (6) of this section. Any amounts not necessary for this purpose shall then be used for the deduction of any excess of ordinary nonbusiness deductions over ordinary nonbusiness gross income. See paragraph (a) (7) of this section. The remainders, computed by applying the excess ordinary nonbusiness deductions proportionately against the excess long-term and excess short-term capital gains, shall be treated as long-term and short-term capital gains, respectively, and may be used for the purpose of determining the deductibility of business long-term and short-term capital losses under paragraph (a) (5) of this section.

Example. A, an individual, has a total nonbusiness gross income of $20,500, computed as follows:

Ordinary gross income	$7,500
Long-term capital gains	6,000
Short-term capital gains	7,000
Total gross income	20,500

He also has total nonbusiness deductions of $16,000, computed as follows:

Ordinary deductions	$9,000
Long-term capital losses	2,000
Short-term capital losses	5,000
Total deductions	16,000

In order to determine the portion of the nonbusiness long-term and short-term capital gains available for the deduction of business long-term and short-term capital losses there must first be deducted the amounts of the nonbusiness long-term and short-term capital losses, respectively. It is then found that the excess long-term capital gains amount to $4,000 ($6,000 minus $2,000), and the excess short-term capital gains to $2,000 ($7,000 minus $5,000). Since the ordinary nonbusiness deductions exceed the ordinary nonbusiness gross income by $1,500 ($9,000 minus $7,500), $1,500 of the $4,000 excess long-term and $2,000 excess short-term capital gains must be used to permit the allowance of such $1,500 under paragraph (a) (7) of this section. Two-thirds of the $1,500 excess of ordinary deductions over ordinary gross income, i. e., $1,000, will therefore be deducted from the $4,000 of excess long-term capital gains, leaving $3,000 to be added to the business long-term capital gains for the purpose of determining the deductibility of any business long-term capital losses. Similarly, one-third of the $1,500 excess of ordinary deductions over ordinary gross income, i. e., $500, will be deducted from the $2,000 excess short-term capital gains, leaving $1,500 to be added to the business short-term capital gains, for the purpose of determining the deductibility of any business short-term capital losses.

(2) *Taxable years beginning after December 31, 1941.* In the computation of a net operating loss a taxpayer other than a corporation must, for taxable years beginning after December 31, 1941, use his nonbusiness capital gains for the deduction of his nonbusiness capital losses. See paragraph (a) (6) of this section. Any amounts not necessary for this purpose shall then be used for the deduction of any excess of ordinary nonbusiness deductions over ordinary nonbusiness gross income. See paragraph (a) (7) of this section. The remainders, computed by applying the excess ordinary nonbusiness deductions against the excess capital gains, shall be treated as capital gains and may be used for the purpose of determining the deductibility of business capital losses under paragraph (a) (5) of this section.

Example. A, an individual, has a total nonbusiness gross income of $20,500, computed as follows:

Ordinary gross income	$7,500
Long-term capital gains	6,000
Short-term capital gains	7,000
Total gross income	20,500

He also has total nonbusiness deductions of $16,000, computed as follows:

Ordinary deductions	$9,000
Long-term capital losses	2,000
Short-term capital losses	5,000
Total deductions	16,000

In order to determine the portion of the nonbusiness capital gains available for the deduction of business capital losses there must first be deducted the amounts of the nonbusiness capital losses. It is then found that the excess capital gains amount to $6,000 ($13,000 minus $7,000). Since the ordinary nonbusiness deductions exceed the ordinary nonbusiness gross income by $1,500 ($9,000 minus $7,500), $1,500 of the $6,000 excess capital gains must be used to permit the allowance of such $1,500 under paragraph (a) (7) of this section. Therefore, $1,500 excess of ordinary deductions over ordinary gross income will be deducted from the $6,000 of excess capital gains, leaving $4,500 to be added to the business capital gains for the purpose of determining the deductibility of any business capital loss.

(d) *Illustration of computation of net operating loss by a taxpayer other than a corporation.* A, an individual who makes his income tax returns on a calendar year basis, has gross income of $483,000 and deductions (exclusive of a net operating loss deduction) of $600,000 for 1942. Included in gross income are business long-term capital gains (as defined in section 117 (a) (4)) of $25,000 (amount of actual gain $50,000) on assets held for more than 24 months, and nonbusiness income of $10,000. Included among the deductions are a business long-term capital loss (as defined in section 117 (a) (5)) of $30,000 (amount of actual loss $60,000) on a capital asset held for 19 months, and deductions incurred in transactions not connected with a trade or business of $12,000. A has no other items of income or deductions to which section 122 (d) is applicable.

On the basis of these facts A has a net operating loss for 1942 of $110,000, computed as follows:

(1) Deductions for 1942, exclusive of capital losses ($600,000 minus $30,000)		$570,000
(2) Plus amount of actual capital loss ($60,000) to extent such amount does not exceed actual capital gains ($50,000)		50,000
(3) Sum of items (1) and (2)		620,000
(4) Less excess of nonbusiness deductions over nonbusiness income ($12,000 minus $10,000)		2,000
(5) Deductions adjusted as required by section 122 (d) (item (3) minus item (4))		618,000
(6) Gross income for 1942	$483,000	
(7) Plus excess of long-term capital gains actually realized over amount previously taken into account ($50,000 minus $25,000)	25,000	
(8) Gross income adjusted as required by section 122 (d) (item (6) plus item (7))		508,000
(9) Net operating loss for 1942 (item (5) minus item (8))		110,000

For treatment of depletion deductions and tax-free interest, see example in § 29.122–2. For treatment of net short-term capital loss carry-over, net capital loss carry-over, nonbusiness capital gains and losses, and the portion of the nonbusiness capital gains which may be used to permit the deduction of business capital losses, see examples in paragraphs (b) and (c) of this section.

(e) *Joint return by husband and wife.* In the case of a husband and wife, the joint net operating loss for any taxable year for which a joint return is filed is to be computed upon the basis of the combined income and deductions of both spouses, and the exceptions and limitations prescribed by section 122 (d) are to be computed as if the combined income and deductions of both spouses were the income and deductions of one individual.

§ 29.122–4 *Computation of net operating loss carry-overs and net operating loss carry-backs*—(a) *In general.* The aggregate of any net operating loss carry-overs and any net operating loss carry-backs to a taxable year shall be the basis of the net operating loss deduction. In order to compute such deduction, the taxpayer must first determine the part of any net operating losses for the two preceding taxable years which are carry-overs to the current taxable year, and the part of any net operating losses for the two succeeding taxable years which are carry-backs to the current taxable year.

Under section 122 the net operating loss for any taxable year beginning on or after January 1, 1942, may be carried back to the two preceding taxable years (except any such taxable year which began before January 1, 1941) and may be carried over to the two succeeding tax-

able years. The net operating loss for any taxable year beginning before January 1, 1942, may be carried over to the two succeeding taxable years, regardless of whether such year begins before, on, or after January 1, 1941. The amount which is so carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the net income for other taxable years, preceding such taxable year, to which it was carried back or carried over. For the purpose of determining the net income for a taxable year which so absorbs the net operating loss that is carried back or carried over, the various net operating loss carry-overs and carry-backs to such taxable year are considered to be applied in reduction of the net income for such taxable year in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year.

(b) *Portion of net operating loss which is a carry-over or a carry-back to the current taxable year.* The net operating loss sustained in any taxable year beginning before January 1, 1942, may be carried over to the two succeeding taxable years. The entire net operating loss may be carried over to the first succeeding taxable year, and the carry-over to the second succeeding taxable year is the excess of the net operating loss over the net income, if any, for the first succeeding taxable year (computed as provided in paragraph (c) of this section). For example, the taxpayer had a net operating loss of $10,000 in 1940. It had a 1941 net income of $6,000 (computed as provided in paragraph (c) of this section). The carry-over from 1940 to 1942 is $4,000, the excess of the $10,000 loss over the $6,000 net income for 1941.

The net operating loss sustained in any taxable year beginning on or after January 1, 1942, may be carried back to the two preceding taxable years (not considering as a preceding taxable year a year beginning prior to January 1, 1941) and may be carried over to the two succeeding taxable years. The entire net operating loss may be carried back to the second preceding taxable year. However, if the second preceding taxable year began before January 1, 1941, no part of the net operating loss may be carried back to such taxable year, and the net income for such taxable year does not reduce the amount of the net operating loss which may be carried back or carried over to the other taxable years. The net operating loss, to the extent it exceeds the net income, if any (computed as provided in paragraph (c) of this section), for the second preceding taxable year, may then be carried back to the first preceding taxable year. To the extent that the net operating loss exceeds the aggregate of the net income, if any (computed as provided in paragraph (c) of this section), for the two preceding taxable years, it may be carried over to the first succeeding taxable year. To the extent that the net operating loss exceeds the aggregate of the net income, if any (computed as provided in paragraph (c) of this section), for the two preceding taxable years and for the first succeeding taxable year, it may be carried over to the second succeeding taxable year.

Example. The taxpayer has a net operating loss of $100,000 in 1943. It has net income (computed as provided in paragraph (c) of this section) as follows: $10,000 in 1941, $15,000 in 1942, $35,000 in 1944, and $60,000 in 1945. The net operating loss carry-back from 1943 to 1941 is $100,000, an amount equal to the full net operating loss. The carry-back to 1942 is $90,000, the excess of the $100,000 net operating loss over the $10,000 net income for 1941 (computed as provided in paragraph (c) of this section). The carry-over to 1944 is $75,000, the excess of the $100,000 net operating loss over the aggregate of the $10,000 net income for 1941 and the $15,000 net income for 1942 (computed in each instance as provided in paragraph (c) of this section). The carry-over to 1945 is $40,000, the excess of the $100,000 net operating loss over the aggregate of the $10,000 net income for 1941, the $15,000 net income for 1942, and the $35,000 net income for 1944 (computed in each instance as provided in paragraph (c) of this section).

(c) *Computation of net income which is subtracted from net operating loss to determine carry-back or carry-over.* The net income for any taxable year which is subtracted from the net operating loss for another taxable year to determine the portion of such net operating loss which is a carry-back or carry-over to a particular taxable year as provided in paragraph (b) of this section is computed with the following adjustments:

(1) The net operating loss deduction for such taxable year is computed by taking into account only such net operating losses otherwise allowable as carry-overs or carry-backs to such taxable year as were sustained in taxable years preceding the taxable year in which the taxpayer sustained the net operating loss from which the net income is to be deducted.

Example. In computing the net operating loss deduction for 1945, the taxpayer has a carry-over from 1943 of $9,000, a carry-over from 1944 of $6,000, a carry-back from 1946 of $18,000, and a carry-back from 1947 of $14,000, or an aggregate of $47,000 in carry-overs and carry-backs which is the basis for the deduction. In computing the net income for 1945 which is deducted from the net operating loss for 1946 in order to determine the portion of such net operating loss which may be carried over to 1947 or 1948, the net operating loss deduction for 1945 is computed without taking into account the $18,000 carry-back from 1946 or the $14,000 carry-back from 1947. The net operating loss deduction for 1945 is, for the purposes of such computation, the aggregate of the $9,000 carry-over from 1943 and the $6,000 carry-over from 1944, or $15,000, adjusted as provided in § 29.122–5 (relating to the conversion of the aggregate of the net operating loss carry-overs and carry-backs to the taxable year into the net operating loss deduction).

In computing the net income for 1945 which is deducted from the net operating loss for 1947 in order to determine the portion of such loss which may be carried back to 1946 and carried over to 1948 and 1949, the net operating loss deduction for 1945 is computed without taking into account the $14,000 carry-back from 1947, and as so computed is the aggregate of the $9,000 carry-over from 1943, the $6,000 carry-over from 1944, and the $18,000 carry-back from 1946, or $33,000, adjusted as provided in § 29.122–5.

(2) In the case of a corporation, the net income shall be computed in accordance with the exceptions, additions, and limitations applicable in the computation of a net operating loss (see § 29.122–2), except that the net operating loss deduction shall be allowed to the extent provided in subparagraph (1) above.

(3) In the case of a taxpayer other than a corporation, the net income shall be computed in accordance with the first four exceptions, additions, and limitations specified in § 29.122–3 (a), except that the net operating loss deduction shall be allowed to the extent provided in subparagraph (1) above. In lieu of the last three exceptions specified in § 29.122–3 (a), the taxpayer is required only (i) for a taxable year beginning before January 1, 1942, to restrict the amount of his deductions for long-term and short-term capital losses to the amount of his long-term and short-term capital gains, respectively, and (ii) for a taxable year beginning on or after January 1, 1942, to restrict the amount of his deduction for capital losses to the amount of his capital gains. The ordinary nonbusiness deductions are allowed in full if otherwise allowable by law. The exceptions and limitations dependent upon the distinction between business and nonbusiness items of gross income and deductions are not applicable in the computation of the net income to be subtracted in computing carry-backs and carry-overs.

(4) Any deduction which is limited in amount to a percentage of the taxpayer's net income shall be recomputed upon the basis of the net income determined with the adjustments prescribed in the preceding paragraphs.

(5) The net income, as adjusted, shall in no case be considered less than zero.

(d) *Illustration of computation of net operating loss carry-backs and carry-overs.* The application of this section may be illustrated by the following example:

Example. The taxpayer is a corporation making its income tax returns on the calendar year basis. It had no net operating loss in 1939 or 1940, or in 1948 or 1949. Its net income, computed without any net operating loss deduction (it being assumed that none of the other adjustments provided in paragraph (c) of this section is applicable), was $20,000 in 1941, $35,000 in 1942, $30,000 in 1946, and $85,000 in 1947. It sustained net operating losses as follows: $25,000 in 1943, $50,000 in 1944, and $40,000 in 1945. It is assumed for the purposes of this example that the application of § 29.122–5 does not cause any reduction of the amount of the aggregate of the net operating loss carry-overs and carry-backs to any taxable year, so that such aggregate is the net operating loss deduction for such taxable year.

(1) The portions of the $25,000 net operating loss for 1943 which may be used as carry-backs to 1941 and 1942 and as carry-overs to 1944 and 1945 are computed as follows:

(a) For 1941, the carry-back is $25,000, that is, the amount of the net operating loss.

(b) For 1942, the carry-back is $5,000, that is, the excess of the $25,000 net operating loss over the $20,000 net income for 1941 (such net income being determined without

any net operating loss deduction since there is no carry-over to 1941 from 1939 or 1940 and no carry-back from 1942, and the carry-back from 1943 is not taken into account).

(c) For 1944 and 1945, there is no carry-over of the net operating loss for 1943 since such loss does not exceed $55,000, the sum of the net incomes for the two taxable years preceding 1943 computed as provided in paragraph (c) of this section (the $20,000 net income for 1941 and the $35,000 net income for 1942, there being no net operating loss deduction for either taxable year since the carry-backs from 1943 and from 1944 are not taken into account).

(2) The portions of the $50,000 net operating loss from 1944 which may be used as carry-backs to 1942 and 1943 and as carry-overs to 1945 and 1946 are computed as follows:

(a) For 1942, the carry-back is $50,000, that is, the amount of the net operating loss.

(b) For 1943, the carry-back is $20,000, that is, the excess of the $50,000 net operating loss over the $30,000 net income for 1942 (the $35,000 income for 1942 reduced by the $5,000 carry-back from 1943, the carry-back from 1944 not being taken into account).

(c) For 1945, the carry-over is $20,000, that is, the excess of the $50,000 net operating loss over $30,000, the sum of the $30,000 net income for 1942 (computed with the deduction of the $5,000 carry-back from 1943 and without the deduction of the carry-back from 1944) and the $0 net income for 1943 (a year in which a net operating loss was sustained).

(d) For 1946, the carry-over is $20,000, that is, the excess of the $50,000 net operating loss over $30,000, the sum of the $30,000 net income for 1942 (computed with the deduction of the $5,000 carry-back from 1943 and without the deduction of the carry-back from 1944) and the $0 net income for 1943 and 1945 (years in which net operating losses were sustained).

(3) The portions of the $40,000 net operating loss for 1945 which may be used as carry-backs to 1943 and 1944 and as carry-overs to 1946 and 1947 are computed as follows:

(a) For 1943, the carry-back is $40,000, that is, the amount of the net operating loss.

(b) For 1944, the carry-back is $40,000, that is, the excess of the $40,000 net operating loss for 1945 over $0, the net income for 1943 (a year in which a net operating loss was sustained).

(c) For 1946, the carry-over is $40,000, that is, the excess of the $40,000 net operating loss for 1945 over $0, the sum of the net incomes for 1943 and 1944 (years in which net operating losses were sustained).

(d) For 1947, the carry-over is $30,000, that is, the excess of the $40,000 net operating loss for 1945 over $10,000, the sum of the $0 net incomes for 1943 and 1944 and the $10,000 net income for 1946 (such net income for 1946 being computed as the $30,000 income reduced by the net operating loss carry-over of $20,000 from 1944, the $40,000 carry-over to 1946 from 1945 not being taken into account).

For 1941, the net operating loss deduction is determined to be $25,000, that is, the carry-back from 1943.

For 1942, the net operating loss deduction is determined to be $55,000, that is, the aggregate of the carry-back of $5,000 from 1943 and of the carry-back of $50,000 from 1944.

For 1946, the net operating loss deduction is determined to be $60,000, that is, the aggregate of the $20,000 carry-over from 1944 and the $40,000 carry-over from 1945.

For 1947, the net operating loss deduction is determined to be $30,000, that is, the carry-over from 1945.

(e) *Joint return by husband and wife.* If a husband and wife making a joint return for any taxable year did not make a joint return for any of the taxable years involved in the computation of a net operating loss carry-over or a net operating loss carry-back to the taxable year for which the joint return is made, such separate net operating loss carry-over or separate net operating loss carry-back is a joint net operating loss carry-over or joint net operating loss carry-back to such taxable year.

If a husband and wife making a joint return for a taxable year made a joint return for each of the taxable years involved in the computation of a net operating loss carry-over or net operating loss carry-back to such taxable year, the joint net operating loss carry-over or joint net operating loss carry-back to such taxable year is computed in the same manner as the net operating loss carry-over or net operating loss carry-back of an individual under the preceding paragraphs of this section but upon the basis of the joint net operating losses and the combined net income of both spouses.

If a husband and wife making separate returns for a taxable year made a joint return for any or all of the taxable years involved in the computation of a net operating loss carry-over or net operating loss carry-back, the separate net operating loss carry-over or separate net operating loss carry-back of each spouse to the taxable year is computed in the manner set forth in the preceding paragraph of this section, but with the following exceptions and limitations:

(1) The net operating loss of each spouse for a taxable year for which a joint return was made shall be deemed to be the portion of the joint net operating loss (computed in accordance with § 29.122–3 (e)) attributable to the gross income and deductions of such spouse, both gross income and deductions being taken into account to the same extent that they are taken into account in computing the joint net operating loss.

(2) The net income of a particular spouse for any taxable year which is subtracted from the net operating loss of such spouse for another taxable year in order to determine the amount of such loss which may be carried back or carried over to still another taxable year is deemed to be, in a case in which such net income was reported in a joint return, the sum of the following:

(i) The portion of the combined net income of both spouses for such year for which the joint return was made which is attributable to the gross income and deductions of the particular spouse, both gross income and deductions being taken into account to the same extent that they are taken into account in computing such combined net income, and

(ii) The portion of such combined net income attributable to the other spouse, but if such other spouse has a taxable year beginning on the same date as the taxable year in which the particular spouse sustained the net operating loss from which the net income is subtracted, and if such other spouse sustained a net operating loss in such taxable year, then such portion shall first be reduced by such net operating loss of such other spouse. However, such net operating loss of such other spouse shall first be diminished by the excess, if any, of the reduction provided in section 122 (c) for the year in which the net income was realized over the aggregate of the net operating loss carry-overs and net operating loss carry-backs which are taken into account in computing the net operating loss deduction for such taxable year (see (*b*) of the next sentence).

For the purposes of (i) and (ii) above, the combined net income shall be computed as though the combined income and deductions of both spouses were those of one individual, and in such computation:

(*a*) The exceptions, additions, and limitations provided in section 122 (d) (1), (2), and (4) shall apply, and

(*b*) The net operating loss deduction shall be determined without taking into account any net operating loss of either spouse or any joint net operating loss of both spouses which was sustained in a taxable year beginning on or after the date of the beginning of the taxable year in which the particular spouse sustained the net operating loss from which the net income is subtracted.

In the following examples, which illustrate subparagraphs (1) and (2) above, it is assumed that there are no items of adjustment under section 122 (d) (1), (2), and (4), and the net income or loss in each case is the net income or loss determined without any net operating loss deduction. The taxpayers in each example, H, a husband, and W, his wife, report their income on the calendar year basis.

Example (1). H and W filed joint returns for 1941 and 1942. They sustained a joint net operating loss of $1,000 for 1941 and a joint net operating loss of $2,000 for 1942. For 1941, the deductions of H exceeded his gross income by $700, and the deductions of W exceeded her gross income by $300, the total of such amounts being $1,000. Therefore, $700 of the $1,000 joint net operating loss for 1941 is considered the net operating loss of H for 1941, and $300 of such joint net operating loss is considered the net operating loss of W for 1941. For 1942 the gross income of H exceeded his deductions, so that his separate net income would be $1,500, and the deductions of W exceeded her gross income by $3,500. Therefore, all of the $2,000 joint net operating loss for 1942 is considered the separate net operating loss of W for 1942.

Example (2). H and W filed joint returns for 1939 and 1941, and separate returns for 1940 and 1942. For such years they had net incomes and net operating losses as follows:

	1939	1940	1941	1942
H	[1] $5,000	[1] $2,500	[2] $6,500	[1] $4,000
W	[1] 3,000	[2] 2,000	[2] 3,000	[1] 1,500
	[3] 8,000		[4] 9,500	

[1] Loss. [2] Income. [3] Joint loss. [4] Combined income.

The net operating loss carry-over of H from 1942 to 1943 is $4,000, that is, his $4,000 net operating loss for 1942 which is not reduced by any part of the net income for 1941, since none of such net income is attributable to H and the portion attributable to W is entirely offset by her separate net operating loss deduction for her taxable year 1942, which taxable year begins on the same date as H's taxable year 1942. The determination of

the amount ($0) of net income for 1941 which reduces H's net operating loss for 1942 is made as follows:

The combined net income of $9,500 for 1941 is reduced to $1,000 by the net operating loss deduction for such year of $8,500. This net operating loss deduction is computed without taking into account any net operating loss sustained in a taxable year beginning on or after January 1, 1942, the date of the beginning of the taxable year in which H sustained the net operating loss which is a carry-over to 1943. This $8,500 amount is composed of H's carry-overs of $5,000 from 1939 and $2,500 from 1940, or a total of $7,500, and of W's carry-over of $1,000 from 1939 (the excess of W's $3,000 loss for 1939 over her $2,000 income for 1940). None of the $1,000 combined net income for 1941 (computed with the net operating loss deduction described above) is attributable to H since it is caused by W's income (computed after deducting her separate carry-over) offsetting H's loss (computed by deducting from his income his separate carry-overs). No part of the $1,000 net income for 1941 which is attributable to W is used to reduce H's net operating loss for 1942 since such net income attributable to W must first be reduced by W's $1,500 net operating loss for 1942, her taxable year beginning on the same date as the taxable year of H in which he sustained the net operating loss from which the net income is subtracted.

The net operating loss carry-over of W from 1942 to 1943 is $500, her $1,500 loss reduced by the $1,000 net income for 1941, computed in the manner prescribed in the preceding paragraph, since all of such net income is attributable to her.

Example (3). Assume the same facts as in example (2), except that for 1942 the net operating loss of W is $200 instead of $1,500.

The net operating loss carry-over of H from 1942 to 1943 is $3,200, that is, his $4,000 net operating loss reduced by $800 of the net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to H. To the $0 net income attributable to H there is added $800, the excess of the $1,000 net income attributable to W over her $200 net operating loss sustained in 1942, a taxable year beginning on the same date (January 1, 1942) as the taxable year of H (1942) in which he sustained the $4,000 net operating loss from which the net income is subtracted. See paragraph (2) (ii) above.

W has no net operating loss carry-over from 1942 to 1943 since her net operating loss of $200 for 1942 does not exceed the $1,000 net income for 1941 attributable to her.

Example (4). Assume the same facts as in example (2) except that W changes her accounting period in 1942 to a fiscal year ending on January 31, and has neither income nor losses for the taxable year January 1, 1942, to January 31, 1942, but has a net operating loss of $200 for the fiscal year February 1, 1942, to January 31, 1943.

The net operating loss carry-over of H from 1942 to 1943 is $3,000, that is, his net operating loss of $4,000 for 1942 reduced by the $1,000 net income for 1941, computed as follows:

The combined net income for 1941, computed with the net operating loss deduction in the manner described in example (2), remains $1,000, no part of which is attributable to H. To the $0 net income attributable to H there is added the $1,000 net income attributable to W. The net income attributable to W is not reduced by any amount since she does not have a net operating loss for her taxable year beginning on January 1, 1942, the date of the beginning of the taxable year of H in which he sustained the $4,000 net operating loss from which the net income is deducted.

The net operating loss carry-over of W from the fiscal year beginning February 1, 1942, to her next fiscal year is $200, her net operating loss for such year. This net operating loss is not reduced by any amount of net income for 1941, since there is no net income for 1941 when computed for the purpose of determining the carry-over of W's net operating loss for her fiscal year beginning February 1, 1942. For such purpose, the net income of $9,500 for 1941 is reduced to $0 by the net operating loss deduction for such year of $12,500, computed without taking into account any net operating loss sustained in a taxable year beginning on or after February 1, 1942, the date of the beginning of the taxable year in which W sustained the net operating loss which is the basis for the carry-over. This $12,500 amount is composed of H's carry-overs of $5,000 from 1939 and $2,500 from 1940, and his carry-back of $4,000 from 1942 (the calendar year beginning January 1, 1942), and of W's carry-over of $1,000 from 1939 (the excess of her $3,000 loss for 1939 over her $2,000 income for 1940).

If a husband and wife making a joint return for any taxable year made a joint return for one or more but not all of the taxable years involved in the computation of a net operating loss carry-over or net operating loss carry-back to such taxable year, such net operating loss carry-over or net operating loss carry-back to the taxable year is computed in the manner set forth in subparagraphs (1) and (2) above. Such net operating loss carry-over or net operating loss carry-back is considered a joint net operating loss carry-over or joint net operating loss carry-back to such taxable year. For example, if in examples (2) and (3) of this paragraph a joint return was filed for 1943, the same amounts computed in those examples as carry-overs of H and W to that year would be the amounts considered joint net operating loss carry-overs to that year.

The joint net operating loss carry-overs and joint net operating loss carry-backs to any taxable year for which joint return is made are all the net operating loss carry-overs and net operating loss carry-backs of both spouses to such taxable year. For example, a husband and wife file a joint return for the calendar year 1943. The wife filed a separate return for the calendar years 1941 and 1942, in which years she sustained net operating losses. The husband filed separate returns for his fiscal year ending June 30, 1942, and, having received permission to change his accounting period to a calendar year basis, for the 6-month period ending December 31, 1942. The husband sustained net operating losses in both such taxable periods. Since the husband and wife did not file a joint return for any taxable year involved in the computation of the net operating loss carry-overs to 1943 from 1941 and 1942 (see the preceding paragraphs of this section), the joint net operating loss carry-overs to 1943 are the separate net operating loss carry-overs of the wife from the calendar years 1941 and 1942 and the separate net operating loss carry-overs of the husband from the fiscal year ending June 30, 1942, and from the short taxable year ending December 31, 1942. If the husband and wife also filed joint returns for the calendar years 1944 and 1945, having joint net income in 1944 and a joint net operating loss in 1945, the joint net operating loss carry-back to 1943 from 1945 is computed upon the basis of the joint net operating loss for 1945, since separate returns were not made for any taxable year involved in the computation of such carry-back.

§ 29.122–5 *Conversion of net operating loss carry-over into net operating loss deduction.* The net operating loss deduction for any taxable year is the aggregate of the net operating loss carry-overs and carry-backs to such taxable year computed as prescribed in § 29.122–4, reduced by the excess of the net income for such taxable year (computed in the same manner as the net income is computed for the purposes of § 29.122–4 except that no net operating loss deduction shall be taken into account and no deduction for excess profits tax imposed by subchapter E of chapter 2 shall be taken into account) over:

(a) In the case of a taxpayer other than a corporation, the net income computed without regard to the exceptions and limitations specified in § 29.122–3 (a) except that no net operating loss deduction shall be taken into account; or

(b) In the case of a corporation, the normal-tax net income computed without regard to the exceptions, additions, and limitations specified in § 29.122–2 except that no net operating loss deduction shall be taken into account and the credit provided in section 26 (e) for income subject to the excess profits tax shall not be allowed.

The application of this section may be illustrated by the following example:

Example. The aggregate of the net operating loss carry-overs and carry-backs to 1942 for the X Corporation is $55,000. Its net income for 1942, computed with the adjustments required by this section, is $450,000 and its normal-tax net income, computed without any exceptions, additions, and limitations except that no net operating loss deduction is allowed and the credit provided in section 26 (e) for income subject to the excess profits tax is not allowed, is $445,000. The net operating loss deduction available to the X Corporation for the year 1942 is $50,000, computed as follows:

Aggregate of net operating loss carry-overs and carry-backs to 1942	$55,000
Less: Excess of net income for 1942, with adjustments, over normal-tax net income for 1942, without adjustments except that no net operating loss deduction shall be allowed and the credit provided in section 26 (e) for income subject to the excess profits tax shall not be allowed ($450,000 minus $445,000)	5,000
Net operating loss deduction for 1942	50,000

If the same facts are assumed for an individual, except that, instead of having a normal-tax net income for 1942 of $445,000, he has a net income in such year of $445,000, computed without adjustment except that no net operating loss deduction shall be allowed, his net operating loss deduction for 1942 will likewise be $50,000, computed in the same manner.

In the case of a husband and wife making a joint return for any taxable year, the computation of the net operating loss

deduction (as set forth in the first paragraph of this section) is to be made upon the basis of the aggregate of the joint net operating loss carry-overs and joint net operating loss carry-backs of the spouses to such year (computed as prescribed in § 29.122–4 (e)) and the combined net income of the spouses.

SEC. 123. COMMODITY CREDIT LOANS [as added by sec. 223 (a), Rev. Act 1939, and amended by sec. 154 (a), Rev. Act 1942].

(a) Amounts received as loans from the Commodity Credit Corporation shall, at the election of the taxpayer, be considered as income and shall be included in gross income for the taxable year in which received.

(b) If a taxpayer exercises the election provided for in subsection (a) for any taxable year beginning after December 31, 1938, then the method of computing income so adopted shall be adhered to with respect to all subsequent taxable years unless with the approval of the Commissioner a change to a different method is authorized.

(c) The election provided for in subsection (a) with respect to taxable years beginning after December 31, 1938, and before January 1, 1942, may be exercised by the taxpayer at, or at any time prior to, the time prescribed for the filing of the taxpayer's return for the taxable year of the taxpayer beginning in 1942, or if there is more than one taxable year of the taxpayer beginning in 1942, for the last taxable year so beginning, provided the records of the taxpayer are sufficient to permit an accurate computation of income for such years, and the taxpayer consents in writing to the assessment, within such period as may be agreed upon, of any deficiency for such years, even though the statutory period for the assessment of any such deficiency had expired prior to the filing of such consent.

§ 29.123–1 *Election to include loans in income.* A taxpayer who receives a loan from the Commodity Credit Corporation may, at his election, include the amount of such loan in his gross income for the taxable year in which the loan is received. If a taxpayer makes such an election, then for subsequent taxable years he shall include in his gross income all amounts received during those years as loans from the Commodity Credit Corporation, unless he secures the permission of the Commissioner to change to a different method of accounting. Application for permission to change such method of accounting and the basis upon which the return is made shall be filed within 90 days after the beginning of the taxable year to be covered by the return.

§ 29.123–2 *Effect of election on adjustments for other taxable years.* If a taxpayer elects or has elected under section 123 of the Internal Revenue Code or section 223 (d) of the Revenue Act of 1939, as amended, to include in his gross income the amount of a loan from the Commodity Credit Corporation for the taxable year in which it is received, then:

(a) No part of the amount realized by the Commodity Credit Corporation upon the sale or other disposition of the commodity pledged for such loan shall be recognized as income to the taxpayer, unless the taxpayer receives an amount in addition to that advanced to him as the loan, in which event such additional amount shall be included in the gross income of the taxpayer for the year in which received; and

(b) No deductible loss to the taxpayer shall be recognized on account of any deficiency realized by the Commodity Credit Corporation on such loan if the taxpayer was relieved from liability for such deficiency.

Example. A, a taxpayer who elected for his taxable years 1938, 1939, and 1940 to include in gross income amounts received during those years as loans from the Commodity Credit Corporation, received as loans $500 in 1938, $700 in 1939, and $900 in 1941. In 1942 all the pledged commodity was sold by the Commodity Credit Corporation for an amount $100 and $200 less than the loans with respect to the commodity pledged in 1938 and 1939, respectively, and for an amount $150 greater than the loan with respect to the commodity pledged in 1941. A, in making his return for 1942, shall include in gross income the sum of $150 if it is received during that year, but will not be allowed a deduction for the deficiencies of $100 and $200 unless he is required to satisfy such deficiencies and does satisfy them during that year.

SEC. 124. AMORTIZATION DEDUCTION [as added by sec. 302, 2d Rev. Act 1940, and amended by secs. 1–3, Pub. Law 3, approved January 31, 1941; secs. 1–3, Pub. Law 285, approved October 30, 1941; Pub. Law 436, approved February 6, 1942; sec. 155 (a) (b) (c) (d) (e) (f), Rev. Act 1942].

(a) *General rule.* Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (e)), based on a period of sixty months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (g) of this section, be in lieu of the deduction with respect to such facility for such month provided by section 23 (l), relating to exhaustion, wear and tear, and obsolescence. The sixty-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

(b) *Election of amortization.* The election of the taxpayer to take the amortization deduction and to begin the sixty-month period with the month following the month in which the facility was completed or acquired shall (except as provided in subsection (d) (3)) be made only by a statement to that effect in its return for the taxable year in which the facility was completed or acquired. Its election to take the amortization deduction and to begin such period with the taxable year succeeding such year shall be made only by a statement to that effect in its return for such succeeding taxable year. In the case of an emergency facility completed or acquired (1) after December 31, 1939, and before June 11, 1940, by a corporation, or (2) after December 31, 1939, and before January 1, 1942, by a person other than a corporation, the taxpayer's election to take the amortization deduction and to begin such period with either the month following the month in which the facility was completed or acquired or with the succeeding taxable year shall be made only by a statement in writing to that effect to the Commissioner and shall be made before the expiration of six months after the date of enactment of the Revenue Act of 1942.

(c) *Termination of amortization deduction.* A taxpayer which has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deductions with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Commissioner before the beginning of such month. The deduction provided under section 23 (l) shall be allowed, beginning with the first month as to which the amortization deduction is not applicable, and the taxpayer shall not (except as provided in subsection (d)) be entitled to any further amortization deductions with respect to such emergency facility.

(d) *Termination of amortization period.* (1) If the President has proclaimed the ending of the emergency period (as defined in subsection (e)), or if the Secretary of War or the Secretary of the Navy has, in accordance with regulations prescribed by the President, certified to the Commissioner that an emergency facility ceased, on the date specified in the certificate, to be necessary in the interest of national defense during the emergency period, and if the date of such proclamation or the date specified in such certificate occurs within sixty months from the beginning of the amortization period with respect to such emergency facility, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the sixty-month period.

(2) If the date of the proclamation or the date specified in the certificate referred to in paragraph (1) of this subsection occurs within sixty months from the beginning of the amortization period with respect to such emergency facility and after the beginning of the month which the taxpayer has previously fixed under subsection (c) for the taking, in lieu of the amortization deduction provided in this section, of the deduction allowed by section 23 (l), the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the sixty-month period, and the termination of the amortization deduction under subsection (c) shall be disregarded.

(3) In the case of a taxpayer which has not elected, in the manner prescribed in subsection (b), to take an amortization deduction with respect to an emergency facility, if the date of the proclamation or the date specified in the certificate, referred to in paragraph (1) of this subsection, whichever is earlier, is before the expiration of sixty months from the last day of the month in which such emergency facility was completed or acquired, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) the amortization deduction provided in subsection (a), using an amortization period beginning with the month following the month in which the emergency facility was completed or acquired and ending as of the end of the month within which such proclamation was issued or within which occurred the date specified in such certificate, whichever is the earlier.

(4) The election provided in paragraph (1), (2), or (3) shall be made by filing with the Commissioner, in such manner, in such form,

and within such time, as the Commissioner with the approval of the Secretary may by regulations prescribe, a statement of such election. When such election has been so made, then, under regulations prescribed by the Commissioner with the approval of the Secretary, the taxes for all taxable years, beginning with the taxable year in which the amortization period began, shall be computed in accordance with an amortization deduction computed in accordance with the method provided in subsection (a), but using (in lieu of the sixty-month period provided in such subsection) the amortization period specified in paragraph (1), (2), or (3), as the case may be.

(5) *Recomputation of tax in case of election under this subsection.* If the adjustment of the income or excess-profits tax liability for any taxable year necessary to give effect to paragraph (4) of this subsection is prevented (A) on the date of the certificate of the Secretary of War or the Secretary of the Navy or on the date of the President's proclamation, whichever is the basis of the taxpayer's election under this subsection, or (B) within one year from such date, by any provision of law (other than this paragraph and other than section 3761, relating to compromises), an adjustment of the tax liability shall nevertheless be made if in respect of such taxable year a notice of deficiency is mailed or a claim for refund is filed, as the case may be, within one year after the date of such certificate or such proclamation, whichever is the basis of the taxpayer's election under this subsection. If at the time of the mailing of such notice of deficiency or the filing of such claim for refund, the adjustment is so prevented, then the amount of the adjustment authorized in this paragraph shall be limited to the increase or decrease in the tax previously determined for such taxable year which results solely from the effect of paragraph (4) of this subsection, and such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if on the date of such certificate or such proclamation, whichever is the basis of the taxpayer's election under this subsection, one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with section 3801 (d). The amount to be assessed and collected under this paragraph in the same manner as if it were a deficiency, or to be refunded or credited in the same manner as if it were an overpayment, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (4) of this subsection. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (4) of this subsection.

(6) In the case of a taxpayer which has not elected, in the manner prescribed in subsection (b), to take an amortization deduction with respect to an emergency facility, if the date of the proclamation referred to in paragraph (1) of this subsection or the date specified in the certificate referred to in paragraph (1) of this subsection is before the completion of such emergency facility, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) the amortization deduction provided in subsection (a), using an amortization period beginning with the month in which the construction, reconstruction, erection, or installation of the emergency facility was begun and ending as of the end of the month within which such proclamation was issued or within which occurred the date specified in the certificate referred to in paragraph (1) of this subsection, whichever is the earlier.

(e) *Definitions*—(1) *Emergency facility.* As used in this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made. For the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed by any person after December 31, 1939, and not earlier than six months prior to the filing of an application for a certificate under subsection (f), and with respect to which part a certificate under subsection (f) has been made, shall be deemed to be an emergency facility, notwithstanding that the other part of such facility was constructed, reconstructed, erected, or installed earlier than six months prior to the filing of such application. For the purposes of this section, the part of any facility which was constructed, reconstructed, erected, or installed by a corporation after December 31, 1939, and before June 11, 1940, and with respect to which part a certificate under subsection (f) has been made, shall be deemed to be an emergency facility and to have been completed on June 10, 1940, notwithstanding that the entire facility was not completed until after June 10, 1940.

(2) *Emergency period.* As used in this section, the term "emergency period" means the period beginning January 1, 1940, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities with respect to which certifications under subsection (f) have been made is no longer required in the interest of national defense.

(f) *Determination of adjusted basis of emergency facility.* In determining, for the purposes of subsection (a) or subsection (h), the adjusted basis of an emergency facility—

(1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense during the emergency period, which certification shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President.

(2) After the completion or acquisition of any emergency facility with respect to which a certificate under paragraph (1) has been made, any expenditure (attributable to such facility and to the period after such completion or acquisition) which does not represent construction, reconstruction, erection, installation, or acquisition included in such certificate, but with respect to which a separate certificate is made under paragraph (1), shall not be applied in adjustment of the basis of such facility and shall be considered as an expenditure with respect to a new emergency facility; and

(3) The certificate provided for in paragraph (1) shall have no effect unless an application therefor is filed before the expiration of six months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, or before December 1, 1941, whichever is later, except that—

(A) In the case of an emergency facility completed or acquired by a corporation after December 31, 1939, and before June 11, 1940, such certificate shall have no effect unless an application therefor is filed before the expiration of six months after the date of the enactment of the Revenue Act of 1942, and

(B) In the case of an emergency facility completed or acquired after December 31, 1939, by a person other than a corporation, such certificate shall have no effect unless an application therefor is filed before the expiration of six months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, or before the expiration of six months after the date of the enactment of the Revenue Act of 1942, whichever is later.

In no event and notwithstanding any of the other provisions of this section, no amortization deduction shall be allowed in respect of any emergency facility for any taxable year—

(C) unless a certificate in respect thereof under paragraph (1) shall have been made (i) prior to the filing of the taxpayer's return for such taxable year, or prior to the making of an election pursuant to subsection (d) (3) or subsection (d) (6) of this section to take the amortization deduction, or (ii) before December 1, 1941, whichever is later; or

(D) in the case of an emergency facility completed or acquired by a corporation after December 31, 1939, and before June 11, 1940, unless a certificate in respect thereof under paragraph (1) shall have been made prior to the expiration of twelve months after the date of enactment of the Revenue Act of 1942; or

(E) in the case of an emergency facility completed or acquired after December 31, 1939, and before January 1, 1943, by a person other than a corporation, unless a certificate in respect thereof under paragraph (1) shall have been made (i) prior to the expiration of nine months after the last date upon which an application for such certificate may be filed, or (ii) prior to the expiration of twelve months after the date of enactment of the Revenue Act of 1942, whichever is later.

(g) *Depreciation deduction.* If the adjusted basis of the emergency facility computed without regard to subsection (f) of this section is in excess of the adjusted basis computed under such subsection, the deduction provided by section 23 (l) shall, despite the provisions of subsection (a) of this section, be allowed with respect to such emergency facility as if its adjusted basis were an amount equal to the amount of such excess.

(h) *Payment by United States of Unamortized cost of facility.* If an amount is properly includible in the gross income of the taxpayer on account of a payment with respect to an emergency facility and such payment is certified as provided in this paragraph, then, at the election of the taxpayer in its return for the taxable year in which such amount is so includible—

(1) The amortization deduction for the month in which such amount is so includible shall (in lieu of the amount of the deduction for such month computed under subsection (a)) be the amount so includible, but such deduction shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amortization deduction for such month). Payments referred to in this paragraph shall be payments the amounts of which are certified, under such regulations as the President may prescribe, by either the Secretary of War or the Secretary of the Navy as compensation to the taxpayer for the unamortized cost of the emergency facility made because—

(A) A contract with the United States involving the use of the facility has been terminated by its terms or by cancellation, or

(B) the taxpayer had reasonable grounds (either from provisions of a contract with the United States involving the use of the facility, or from written or oral representations made under authority of the United States) for anticipating future contracts involving the use of the facility, which future contracts have not been made.

(2) In case the taxpayer is not entitled to any amortization deduction with respect to the emergency facility the deduction allowable under section 23 (l) on account of the month in which such amount is so includible shall be increased by such amount, but such deduction on account of such month shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amount allowable, on account of such month, under section 23 (l) or this paragraph).

(i) *Life tenant and remainderman.* In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowable to the life tenant.

§ 29.124–0 *Definitions.* As used in this section and §§ 29.124–1 to 29.124–9, inclusive, the term:

(a) "Secretary of the department concerned" means the Secretary of War or the Secretary of the Navy, as the case may be.

(b) "Emergency facility" means any facility, land, building, machinery, or equipment, or any part thereof:

(1) The acquisition of which occurred after December 31, 1939, or the construction, reconstruction, erection, or installation of which was completed after such date, and

(2) Any part of the construction, reconstruction, erection, installation, or acquisition of which has, under such regulations as may be prescribed by the Secretary of War and the Secretary of the Navy, with the approval of the President, been certified by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period.

The part of any facility which is constructed, reconstructed, erected, or installed by any person after December 31, 1939, and not earlier than six months prior to the filing of an application for a certificate of necessity under section 124 (f), and which is certified by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period, shall be deemed to be an emergency facility, notwithstanding that the other part of such facility was constructed, reconstructed, erected, or installed earlier than six months prior to the filing of such application. If the construction, reconstruction, erection, or installation of a facility by a corporation is begun before June 11, 1940, and completed after June 10, 1940, the part of such facility which is constructed, reconstructed, erected, or installed after December 31, 1939, and before June 11, 1940, shall be deemed to be an emergency facility, provided such part is certified by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period.

The term "emergency facility," as so defined, may include, among other things, improvements of land, such as the construction of airports and the dredging of channels.

(c) "Emergency period" means the period beginning on January 1, 1940, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities is no longer required in the interest of national defense.

§ 29.124–1 *Certificate of necessity.* The certification by the Secretary of the department concerned that a facility is necessary in the interest of national defense during the emergency period shall have no effect:

(a) In the case of an emergency facility completed or acquired by a corporation after June 10, 1940, unless an application therefor is filed before the expiration of six months after the beginning of the construction, reconstruction, erection, or installation of such facility or the date of its acquisition, or before December 1, 1941, whichever is later (but see § 29.124–0 (b));

(b) In the case of an emergency facility completed or acquired by a corporation after December 31, 1939, and before June 11, 1940, unless an application therefor is filed before April 22, 1943; and

(c) In the case of an emergency facility completed or acquired after December 31, 1939, by a person other than a corporation, unless an application therefor is filed before the expiration of six months after the beginning of the construction, reconstruction, erection, or installation of such facility or the date of its acquisition, or before April 22, 1943, whichever is later.

§ 29.124–2 *Amortization deduction; general rule.* If the Secretary of the department concerned makes the required certification of necessity, a person is entitled, at its election, to a deduction with respect to the amortization of the adjusted basis of an emergency facility, such amortization to be based generally on a period of 60 months. As to the adjusted basis of an emergency facility, see § 29.124–6. The taxpayer may, with respect to an emergency facility, elect to begin the 60-month amortization period with (1) the month following the month in which such facility was completed or acquired, or (2) the taxable year succeeding that in which such facility was completed or acquired (see § 29.124–3). The date on which, or the month within which, an emergency facility is completed or acquired is a question to be determined upon the facts in the particular case. Ordinarily the taxpayer is in possession of all the facts and, therefore, in a position to ascertain such date. A statement of the date ascertained by the taxpayer, together with a statement of the pertinent facts relied upon, should be filed with the taxpayer's election to take amortization deductions with respect to such facility. If the construction, reconstruction, erection, or installation of an emergency facility by a corporation is begun before June 11, 1940, and completed after June 10, 1940, the part of such emergency facility which is constructed, reconstructed, erected, or installed after December 31, 1939, and before June 11, 1940, shall be deemed to have been completed on June 10, 1940.

With respect to an emergency facility, no amortization deduction shall be allowed for the taxable year in which or with which the taxpayer elects to begin the 60-month amortization period unless:

(a) In the case of an emergency facility completed or acquired by a corporation after June 10, 1940, a certificate of necessity in respect thereof shall have been made (1) before the filing of the taxpayer's return for such taxable year, or before the making of an election pursuant to section 124 (d) (3) or section 124 (d) (6) to take the amortization deduction, or (2) before December 1, 1941, whichever is later;

(b) In the case of an emergency facility completed or acquired by a corporation after December 31, 1939, and before June 11, 1940, unless a certificate of necessity in respect thereof shall have been made before October 22, 1943;

(c) In the case of an emergency facility completed or acquired by a person other than a corporation after December 31, 1942, unless a certificate of necessity in respect thereof shall have been made before the filing of the taxpayer's return for such taxable year, or before the making of an election pursuant to section 124 (d) (3) or section 124 (d) (6); or

(d) In the case of an emergency facility completed or acquired after December 31, 1939, and before January 1, 1943, by a person other than a corporation, unless a certificate of necessity in respect thereof shall have been made (1) before the expiration of nine months after the last date upon which an application for such certificate may be filed or (2) before October 22, 1943, whichever is later.

In general, with respect to each month of the 60-month period which falls within the taxable year, the amortization deduction is an amount equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the particular month for which the deduction is computed) remaining in the 60-month period. The adjusted basis of the facility at the end of any month shall be computed without regard to the amortization deduction with respect to such facility for such month. The total amortization deduction with respect to an emergency facility for a particular taxable year is the sum of the amortization deductions allowable with respect to such facility for each month of the 60-month period which falls within such taxable year. The amortization deduction with respect to an emergency facility taken for any month is in lieu of the deduction for depreciation which would otherwise be allowable under section 23 (l) with respect to such facility for such month. See, however § 29.124–7, relative to depreciation with respect to any amount not subject to amortization.

This section may be illustrated by the following examples:

Example (1). On July 1, 1942, the X Corporation, which makes its income tax returns on the calendar year basis, begins the construction of an emergency facility which is completed on September 30, 1942, at a cost of $240,000. The certificate of necessity covers the entire construction. The X Corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with October, the month following its completion. The adjusted basis of the facility at the end of October is $240,000. The allowable amortization deduction with respect to

such facility for the taxable year 1942 is $12,000, computed as follows:

Monthly amortization deductions:	
October ($240,000÷60)	$4,000
November ($236,000, or $240,000 minus $4,000÷59)	4,000
December $232,000, or $236,000 minus $4,000,÷58)	4,000
Total amortization deduction for 1942	12,000

Example (2). The Y Corporation, which makes its income tax returns on the basis of a fiscal year ending November 30, purchases an emergency facility (No. 1) on July 29, 1943. On June 15, 1943, it begins the construction of an emergency facility (No. 2), which is completed on August 2, 1943. The entire acquisition and construction of such facilities are certified as necessary in the interest of national defense. The Y Corporation elects to take amortization deduction with respect to both facilities and to begin the 60-month amortization period in each case with the month following the month of acquisition or completion. The adjusted basis of facility No. 1 is $300,000 and the adjusted basis of facility No. 2 is $54,000 at the end of the first month of the amortization period. In September 1943 facility No. 1 is damaged by fire, as a result of which its adjusted basis is properly reduced by $25,370. The allowable amortization deduction with respect to such facilities for the taxable year ending November 30, 1943, is $21,410, computed as follows:

Facility No. 1

Monthly amortization deductions:	
August ($300,000÷60)	$5,000
September ($269,630, or $300,000 minus $5,000 and $25,370,÷59)	4,570
October ($265,060, or $269,630 minus $4,570, ÷ 58)	4,570
November ($260,490, or $265,060 minus $4,570, ÷ 57)	4,570
Amortization deduction for 1943	$18,710

Facility No. 2

Monthly amortization deductions:	
September ($54,000÷60)	$900
October ($53,100÷59)	900
November ($52,200÷58)	900
Amortization deduction for 1943	2,700
Total amortization deduction for 1943	21,410

Example (3). On June 15, 1941, the Z Corporation, which makes its income tax returns on the calendar year basis, completes the construction of an emergency facility at a cost of $110,000. In its income tax return for 1941, filed on March 15, 1942, the Z Corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with July, the month following its completion. No certificate of necessity with respect to such facility is made until April 10, 1942, and therefore no amortization deduction with respect to such facility is allowable for any month in the taxable year 1941. The Z Corporation is entitled, however, to take a deduction for depreciation of such facility for the taxable year 1941, such deduction being assumed, for the purposes of this example, to be $2,000. Accordingly, the adjusted basis of such facility at the end of January 1942 (without regard to the amortization deduction for such month) is $108,000 ($110,000 minus $2,000). For the taxable year 1942, the Z Corporation is, with respect to such facility, entitled to an amortization deduction of $24,000, computed as follows:

Monthly amortization deductions:	
January ($108,000÷54)	$2,000
February ($106,000, or $108,000 minus $2,000, ÷ 53)	2,000
March ($104,000, or $106,000 minus $2,000, ÷ 52)	2,000
For the remaining nine months (similarly computed)	18,000
Total amortization for 1942	24,000

Since the Z Corporation elected in its return for 1941 to take amortization deductions with respect to such facility and to begin the 60-month amortization period with July 1941, it must compute its amortization deductions for the 12 months in the taxable year 1942 on the basis of the remaining months of the established 60-month amortization period, as indicated in the above computation.

Example (4). On March 18, 1940, the R Corporation, which makes its income tax returns on the calendar year basis, begins the construction of a facility which is completed on October 25, 1940, at a cost of $350,000, of which $132,000 is attributable to construction before June 11, 1940, and $218,000 to construction after June 10, 1940. On January 28, 1941, the entire part of the construction after June 10, 1940, is certified as an emergency facility, and the R Corporation, in its income tax return for 1940, elects to take amortization deductions with respect thereto and to begin the 60-month amortization period with November 1940, the month following the month of completion. With respect to the part of the construction before June 11, 1940, the R Corporation in its returns for 1940 and 1941, takes depreciation deductions aggregating $5,000. On February 14, 1943, the entire part of the construction before June 11, 1940, is certified as a separate emergency facility. The R Corporation, in a statement in writing to the Commissioner made before April 22, 1943, elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with July 1940, the month following the month of completion. For such purposes, the adjusted basis of such facility at the end of July 1940 is $132,000. Since amortization deductions are in lieu of depreciation deductions, the depreciation deductions of $5,000 previously taken for 1940 and 1941 are disallowed. The allowable amortization deduction with respect to such facility for the taxable year 1940 is $13,200, computed as follows:

Monthly amortization deductions:	
July ($132,000÷60)	$2,200
August ($129,800÷59)	2,200
September ($127,600÷58)	2,200
For the remaining three months (similarly computed)	6,600
Total amortization deduction for 1940	13,200

The allowable amortization deduction with respect to such facility for the taxable year 1941, similarly computed, is $26,400.

Example (5). On April 1, 1940, A, an individual, who makes his income tax returns on a calendar year basis, acquires a facility at a cost of $182,700. In his returns for the taxable years 1940 and 1941, A takes depreciation deductions with respect to such facility of $2,700 and $3,600, respectively. On February 6, 1943, the facility is certified as an emergency facility and A, in a statement in writing made to the Commissioner before April 22, 1943, elects to take amortization deductions with respect thereto and to begin the 60-month amortization period with the taxable year 1941, the year succeeding the year in which the facility was acquired. The adjusted basis of such facility at the end of January 1941 is $180,000 ($182,700 less the depreciation of $2,700 taken in the return for 1940). Since amortization deductions are in lieu of depreciation deductions, the depreciation deduction of $3,600 previously taken for 1941 is disallowed. The allowable amortization deduction with respect to such facility for the taxable year 1941 is $36,000, computed as follows:

Monthly amortization deductions:	
January ($180,000÷60)	$3,000
February ($177,000÷59)	3,000
March ($174,000÷58)	3,000
For the remaining nine months (similarly computed)	27,000
Total amortization deductions for 1941	36,000

§ 29.124–3 *Election of amortization.* In the case of an emergency facility completed or acquired (1) after June 10, 1940, by a corporation or (2) after December 31, 1941, by a person other than a corporation:

(a) An election by the taxpayer to take amortization deductions with respect thereto and to begin the 60-month amortization period with the month following the month in which such facility was completed or acquired shall be made only by a statement to that effect in its return for the taxable year in which such facility was completed or acquired; and

(b) An election by the taxpayer to take amortization deductions with respect thereto and to begin the 60-month amortization period with the taxable year succeeding that in which such facility was completed or acquired shall be made only by a statement to that effect in its return for such succeeding taxable year.

In the case of an emergency facility completed or acquired (1) after December 31, 1939, and before June 11, 1940, by a corporation, or (2) after December 31, 1939, and before January 1, 1942, by a person other than a corporation, an election by the taxpayer to take amortization deductions with respect thereto and to begin the 60-month amortization period either with the month following the month of completion or acquisition or with the following taxable year shall be made only by a statement in writing to that effect filed with the Commissioner of Internal Revenue, Washington, D. C., before April 22, 1943.

No other method of making such elections is permitted. Any statement of election should contain a description clearly identifying each emergency facility for which an amortization deduction is claimed.

A taxpayer which does not elect, in the manner provided in section 124 (b), to take amortization deductions with respect to an emergency facility shall not, except as provided in sections 124 (d) (3) and 124 (d) (6), be entitled to amortization deductions with respect to such facility (see § 29.124–5 (d)).

§ 29.124–4 *Election to discontinue amortization.* If a taxpayer has elected to take amortization deductions with respect to an emergency facility, it may, after such election and prior to the expiration of the 60-month amortization period, discontinue the amortization deductions with respect to such facility for the remainder of the 60-month period. An election to discontinue the amortization deductions shall be made by a notice

in writing filed with the Commissioner specifying the month as of the beginning of which the taxpayer elects to discontinue the deductions. Such notice shall be filed before the beginning of the month specified therein, and should contain a description clearly identifying the emergency facility with respect to which the taxpayer elects to discontinue the amortization deductions. If the taxpayer so elects to discontinue the amortization deductions with respect to an emergency facility, it shall not, except as provided in section 124 (d), be entitled to any further amortization deductions with respect to such facility (see § 29.124–5 (c)).

A taxpayer which thus elects to discontinue amortization deductions with respect to an emergency facility is entitled, if such facility is depreciable property under section 23 (l) and the regulations pertaining thereto, to a deduction for depreciation with respect to such facility. The deduction for depreciation shall begin with the first month as to which the amortization deduction is not applicable, and shall be computed on the adjusted basis of the property as of the beginning of such month (see section 113 (b) and the regulations thereunder).

This section may be illustrated by the following example:

Example. On July 1, 1942, the X Corporation, which makes its income tax returns on the calendar year basis, purchases an emergency facility, consisting of land with a building thereon, at a cost of $306,000, of which $60,000 is allocable to the land and $246,000 to the building. The certificate of necessity covers the entire acquisition. The corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with the taxable year 1943. Depreciation of the building in the amount of $6,000 is deducted and allowed for the taxable year 1942. On March 25, 1944, the corporation files notice with the Commissioner of its election to discontinue the amortization deductions beginning with the month of April 1944. The adjusted basis of the facility on January 31, 1943, is $300,000, or the cost of the facility ($306,000) less the depreciation allowed for 1942 ($6,000). The amortization deduction for the taxable year 1943 and the months of January, February, and March, 1944, amounts to $75,000, or $5,000 per month for 15 months. Since, at the beginning of the amortization period (January 1, 1943), the adjusted basis of the land is one-fifth of the adjusted basis of the entire facility and since there are no adjustments to basis other than on account of amortization during the period, the adjusted basis of the land should be reduced by $15,000, or one-fifth of the entire amortization deduction, and the adjusted basis of the building should be reduced by $60,000, or four-fifths of the entire amortization deduction. Accordingly, the adjusted basis of the facility as of April 1, 1944, is $225,000, of which $180,000 is allocable to the building for the purpose of depreciation deductions under section 23 (l), and $45,000 is allocable to the land.

§ 29.124–5 *Termination of amortization period*—(a) *Date the emergency use ceases.* As used in this section, the term "date the emergency use ceases" means whichever of the following is the earlier:

(1) The date of the proclamation by the President by reason of which the emergency period ends; or

(2) The date specified in a certificate with respect to an emergency facility made to the Commissioner by the Secretary of the department concerned (in accordance with regulations prescribed by the President) as the date on which such facility ceased to be necessary in the interest of national defense during the emergency period.

(b) *Taxpayer which has elected to amortize.* A taxpayer which has elected to take amortization deductions with respect to an emergency facility may elect, in the manner provided in paragraph (e) of this section, to terminate the amortization period with respect to such facility as of the end of the month in which occurs the date the emergency use ceases, provided that such date occurs prior to the expiration of the original 60-month period. In such case there shall, with respect to such facility, be substituted, in lieu of the original 60-month period, a new amortization period beginning with the first month of the original 60-month period and ending with the end of the month in which occurs the date the emergency use ceases; and the taxpayer's taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124 (a) (see § 29.124–2) but on the basis of the new amortization period.

Example. On August 15, 1942, the X Corporation, which makes its income tax returns on the calendar year basis, acquires an emergency facility for the purpose of performing War Department contracts. The corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with September 1942, the month following the month of acquisition. The Secretary of War certifies to the Commissioner that such facility ceases, as of July 15, 1944, to be necessary in the interest of national defense. The X Corporation elects to terminate the amortization period and, accordingly, there is to be substituted, in lieu of the 60-month amortization period, a new amortization period of 23 months (4 months in 1942, 12 months in 1943, and 7 months in 1944). The X Corporation's taxes for the taxable years 1942, 1943, and 1944 shall be computed or recomputed so as to give effect to amortization deductions computed in the manner provided in section 124 (a) but on the basis of the new 23-month amortization period.

(c) *Taxpayer which has elected to discontinue amortization.* A taxpayer which has elected to take amortization deductions with respect to an emergency facility and has subsequently elected under section 124 (c) (see § 29.124–4) to discontinue, as of the beginning of a specified month, the amortization deductions with respect to such facility may elect, in the manner provided in paragraph (e) of this section, to terminate the amortization period with respect to such facility as of the end of the month in which occurs the date the emergency use ceases, provided that such date occurs prior to the expiration of the original 60-month period and after the beginning of such specified month. In such case, with respect to such facility, the election to discontinue the amortization deductions shall be disregarded and there shall be substituted, in lieu of the original 60-month period, a new amortization period beginning with the first month of the original 60-month period and ending with the end of the month in which occurs the date the emergency use ceases. The taxpayer's taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124 (a) (see § 29.124–2) but on the basis of the new amortization period.

Example. On November 1, 1942, the Y Corporation, which makes its income tax returns on the basis of a fiscal year ending June 30, begins the construction of an emergency facility which is completed on March 15, 1943. The corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with April 1943, the month following the completion. On January 15, 1944, the corporation files a notice with the Commissioner in which it elects to discontinue the amortization deductions with respect to such facility as of the beginning of February 1944. The President issues a proclamation on August 16, 1944, by reason of which the emergency period ends. The Y Corporation then elects to terminate the amortization period and, accordingly, its election to discontinue the amortization deductions is to be disregarded. In such case, there is to be substituted, in lieu of the original 60-month amortization period, a new amortization period of 17 months (3 months in the taxable year ending June 30, 1943, 12 months in the taxable year ending June 30, 1944, and 2 months in the taxable year ending June 30, 1945). The corporation's taxes for the taxable years ending June 30, 1943, 1944, and 1945, are to be computed or recomputed so as to give effect to amortization deductions (in lieu of amortization and depreciation deductions previously taken during such 17-month period) computed in the manner provided in section 124 (a) but on the basis of the new 17-month amortization period.

If the date the emergency use ceases should occur between the date of the notice of discontinuance and the beginning of the month specified in such notice, the provisions of section 124 (d) (1) and paragraph (b) of this section are applicable.

(d) *Taxpayer which has not elected to amortize*—(1) *General rule.* A taxpayer which has obtained the required certifications but has not elected, as provided in section 124 (b), to take amortization deductions with respect to the emergency facility to which such certifications relate may nevertheless take amortization deductions with respect to such facility, if (i) the date the emergency use ceases occurs before the expiration of 60 months from the last day of the month in which such facility was completed or acquired, and (ii) an election to take such amortization deductions is made in the manner prescribed in paragraph (e) of this section. In such case, the taxes for all taxable years (beginning with the taxable year in which fell the month following the month in which such facility was completed or acquired) shall be computed (or recomputed) so as to give effect to amortization deductions

with respect to such facility computed in the manner provided in section 124 (a) (see § 29.124–2) but on the basis of an amortization period beginning with the month following the month in which such facility was completed or acquired, and ending with the last day of the month in which occurs the date the emergency use ceases.

Example. On September 25, 1942, the Z Corporation, which makes its income tax returns on the calendar year basis, acquires an emergency facility for the purpose of performing Navy Department contracts. The corporation does not elect to take amortization deductions with respect to such facility. The Secretary of the Navy certifies to the Commissioner that such facility ceased, as of July 20, 1944, to be necessary in the interest of national defense. The Z Corporation may elect, in the manner provided in paragraph (e) of this section, to take amortization deductions with respect to such facility and in such case its taxes for the taxable years 1942, 1943, and 1944 are to be computed or recomputed so as to give effect to amortization deductions computed in the manner provided in section 124 (a) but on the basis of an amortization period of 22 months (3 months in 1942, 12 months in 1943, and 7 months in 1944), such amortization deductions to be in lieu of depreciation deductions previously taken during such 22-month period.

(2) *Special rule with respect to incompleted facilities.* If the date the emergency use ceases occurs after the beginning of the construction, reconstruction, erection, or installation of an emergency facility and such construction, reconstruction, erection, or installation is not completed, the taxpayer may elect, in the manner prescribed in paragraph (e) of this section, to take amortization deductions with respect to such facility, such amortization to be based on a period beginning with the month in which the construction, reconstruction, erection, or installation of such facility was begun and ending as of the end of the month in which occurs the date the emergency use ceases.

(e) *Manner of making election.* The election described in paragraph (b), (c), or (d) of this section shall be made by filing with the Commissioner of Internal Revenue, Washington, D. C., a statement of such election. Such statement shall be filed within 90 days after the date of the President's proclamation or the date of the certificate of the Secretary of the department concerned, whichever is the basis of the taxpayer's election, and should contain a description clearly identifying the facility. A copy of such statement should be attached by the taxpayer to the income-tax return for the taxable year in which falls the date the emergency use ceases.

(f) *Recomputation of taxes in case of commuted amortization period.* The recomputation of the tax liability authorized by section 124 (d) (4) applies to any income or excess-profits tax imposed under chapter 1 or subchapter A, B, D, or E of chapter 2, to the capital stock tax imposed by chapter 6, and to any other tax of the corporation affected directly or indirectly by the recomputation of the amortization deduction.

Under section 124 (d) (5), if the adjustment of any income or excess-profits tax for any taxable year to give effect to the revised amortization deduction is prevented (1) on the date of the certificate of the Secretary of the department concerned or the date of the President's proclamation, whichever forms the basis of the taxpayer's election, or (2) within one year after such date, by any provision of law (other than section 3761, relating to compromises, and other than section 124 (d) (5) or by any rule of law, including the doctrine of res judicata, an adjustment shall nevertheless be made if a claim for refund or credit is filed or a notice of deficiency is mailed, as the case may be, within one year after the date of such certificate or proclamation. Section 124 (d) (5) applies only if, at the time of the filing of the claim for refund or the mailing of the notice of deficiency, the adjustment would otherwise be prevented by the running of the statute of limitations, by the execution of a closing agreement, by the operation of the rule of res judicata, or for other reasons. For reference to provisions which would prevent adjustment except for the provisions of section 124 (d) (5), see § 29.3801 (b)–0. Section 124 (d) (5) is not applicable, however, if on the date of the filing of the claim for refund or the mailing of the notice of deficiency, adjustment of the tax liability is permissible without recourse to such section.

The amount of the adjustment authorized by section 124 (d) (5) is limited to the increase or decrease in the tax previously determined for the taxable year which results solely from the revision of the amortization deduction and the collateral effects of such revision upon items of income, deductions, credits, invested capital, etc., already taken into account in ascertaining the tax previously determined. The tax previously determined for any taxable year is to be ascertained in accordance with the provisions of section 3801 (d). See § 29.3801 (d)–1. If the amount of the adjustment determined under section 124 (d) (5) represents an increase in tax, it is to be treated in the same manner as a deficiency for the taxable year; if it represents a decrease in tax, it is to be treated in the same manner as an overpayment for the taxable year. The amount of the adjustment considered as a deficiency or as an overpayment, as the case may be, will bear interest to the extent provided by the internal revenue laws applicable to deficiencies and overpayments for the taxable year for which the adjustment is made.

The amount of any adjustment under the provisions of section 124 (d) (5) which is refunded may not subsequently be recovered in a suit for erroneous refund based upon any adjustment other than one resulting from the revision of the amortization deductions. The amount of any adjustment under section 124 (d) (5) which is assessed and collected as a deficiency may not thereafter be recovered by the taxpayer in any suit for refund based upon any adjustment other than one resulting from the revision of the amortization deductions. The application of the provisions of section 124 (d) (5) may be illustrated by the following example:

Example. On August 31, 1942, the X Corporation, which makes its income tax returns on the calendar year basis, acquires an emergency facility at a cost of $300,000 and elects to take amortization deductions with respect to such facility over the 60-month period beginning with the month of September 1942. For the taxable year 1942 the corporation files an income tax return disclosing a net income of $73,800, corporation surtax net income of $65,300, and normal tax net income of $65,300. The return discloses a tax liability of $19,993, which is assessed and paid. In making such computation, the corporation takes amortization deductions of $5,000 a month for four months, or $20,000, but in computing its gross income erroneously omits interest income amounting to $6,000, and in computing its deductions erroneously omits a deduction for insurance expense of $2,000. The corporation includes in gross income dividends from a domestic corporation in the amount of $10,000 and takes a dividends received credit of $8,500. It also files an excess-profits tax return under subchapter E of chapter 2 disclosing an invested capital of $637,500, an excess-profits net income of $68,000, an excess-profits credit of $51,000 computed on the invested capital basis, and an excess-profits tax liability of $4,200.

On September 1, 1946, the Secretary of the department concerned certifies to the Commissioner that such emergency facility ceased as of August 15, 1946, to be necessary in the interest of national defense. The X Corporation elects to terminate the amortization period and to amortize the adjusted basis of such facility over the shortened period of 48 months beginning September 1, 1942, and ending August 31, 1946. The corporation is therefore entitled to compute or recompute its taxes for 1942, 1943, 1944, 1945, and 1946 on the basis of an amortization deduction of $6,250 in lieu of $5,000 for each month beginning with September 1942 and ending with August 1946. The allowable deduction for 1942 is therefore $25,000 in lieu of $20,000. Claims for refund for all years, except 1946, are filed on November 30, 1946. For the taxable year 1942 the period of limitations upon the filing of a claim for refund provided by section 322 expires on March 15, 1946. Since, however, the claim is filed within one year from the date of the certificate of the Secretary of the department concerned, an adjustment is authorized under section 124 (d) (5). The amount of the adjustment of the income taxes under sections 13 and 15 and the excess-profits tax under subchapter E of chapter 2 for 1942 is $2,758 (income taxes, $1,008; excess-profits tax, $1,750), computed as follows:

EXCESS-PROFITS TAX

Excess-profits net income reported		$68,000.00
Less: Additional deduction for amortization		5,000.00
Excess-profits net income as recomputed		63,000.00
Less:		
Excess-profits credit	$51,000.00	
Specific exemption	5,000.00	
		56,000.00
Adjusted excess-profits net income		7,000.00
Excess-profits tax as recomputed		2,450.00
Tax previously determined and paid		4,200.00
Amount of adjustment under section 124 (d) (5) to be refunded or credited		1,750.00

INCOME TAX

Net income upon which tax previously determined was based		$73,800.00
Less: Additional deduction for amortization:		
Amount deductible	$25,000.00	
Amount deducted in return	20,000.00	
		5,000.00
Balance		68,800.00
Add: Adjustment for excess-profits tax:		
Amount previously deducted	$4,200.00	
As recomputed	2,450.00	
		1,750.00
Net income as recomputed		70,550.00
Less: Dividends received credit		8,500.00
Corporation surtax net income		62,050.00
Less: Interest on obligations of the United States and its instrumentalities		None
Normal tax net income		62,050.00
Surtax on $25,000	$1,500.00	
Surtax on $37,050	2,593.50	
Normal tax on $62,050	14,892.00	
Income tax as recomputed		18,985.50
Income tax previously determined		19,993.00
Amount of adjustment under section 124 (d) (5) to be refunded or credited		1,007.50

By reason of the limitations imposed by section 124 (d) (5), the adjustment is limited to the decrease in the tax previously determined which results solely from the revision of the amortization deductions and the consequences flowing therefrom. Accordingly, the recomputation does not take into consideration the item of $6,000, representing interest received, which was omitted from gross income, or the item of $2,000, representing insurance expense, for which no deduction was allowed.

Since the claims for refund for the taxable years 1943, 1944, and 1945 were filed within the period of limitations provided in section 322, the provisions of section 124 (d) (5) are not applicable and the complete adjustment of the taxes for such taxable years may be made without regard to the limitations contained in section 124 (d) (5).

§ 29.124–6 *Adjusted basis of emergency facility*—(a) *In general.* The adjusted basis of an emergency facility for purposes of computing the amortization deduction may differ from what would otherwise constitute the adjusted basis of such emergency facility, in that it shall be the adjusted basis for determining gain (see section 113) and in that it may be only a portion of what would otherwise constitute the adjusted basis. It will be only a portion of such other adjusted basis if only a portion of the basis (unadjusted) is attributable to the certified construction, reconstruction, erection, installation, or acquisition after December 31, 1939. It is therefore necessary first to determine the unadjusted basis of the emergency facility from which the adjusted basis for amortization purposes is derived.

The unadjusted basis for amortization purposes, n cases where the entire construction, reconstruction, erection, installation, or acquisition takes place after December 31, 1939, and such construction, reconstruction, erection, installation, or acquisition is certified in its entirety by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period, is the same as the unadjusted basis otherwise determined.

In cases where the Secretary of the department concerned certifies the entire construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as necessary in the interest of national defense during the emergency period, but only a portion of the construction, reconstruction, erection, installation, or acquisition attributable to the facility takes place after December 31, 1939, the unadjusted basis for the purposes of amortization is so much of the entire unadjusted basis as is attributable to that portion of the construction, reconstruction, erection, installation, or acquisition which took place after December 31, 1939. For example, the X Corporation begins the construction of a facility November 15, 1939, and such facility is completed on April 1, 1940, at a cost of $500,000, of which $300,000 is attributable to construction after December 31, 1939. The certificate of necessity covers the entire construction after December 31, 1939, and the unadjusted basis of the emergency facility for amortization purposes is therefore $300,000. For depreciation of the remaining portion of the cost ($200,000), see § 29.124–7.

If the Secretary of the department concerned certifies only a portion of the construction, reconstruction, erection, installation, or acquisition after December 31, 1939, then the unadjusted basis for amortization purposes is limited to the amount attributable to such portion of the construction, reconstruction, erection, installation, or acquisition after December 31, 1939. Assuming the same facts as in the example in the preceding paragraph, except that the certificate is to the effect that only 50 percent of the construction after December 31, 1939, is necessary in the interest of national defense during the emergency period, the unadjusted basis for amortization purposes is 50 percent of $300,000, or $150,000.

Where a corporation begins the construction, reconstruction, erection, or installation of a facility before June 11, 1940, and completes it after June 10, 1940, the part of such construction, reconstruction, erection, or installation taking place after December 31, 1939, and before June 11, 1940, and the part thereof taking place after June 10, 1940, each constitutes a separate emergency facility, provided a certificate of necessity under section 124 (f) has been made with respect to each such part (see section 124 (e) and § 29.124–0). Furthermore, the part of such construction, reconstruction, erection, or installation taking place after December 31, 1939, and before June 11, 1940, is deemed to have been completed on June 10, 1940 (see section 124 (e) (1) and § 29.124–2). Accordingly, under such circumstances, in applying the foregoing rules for determining the unadjusted basis of the emergency facility representing the part of the construction, reconstruction, erection, or installation taking place after June 10, 1940, the date "June 10, 1940" should be substituted for the date "December 31, 1939."

The adjusted basis of an emergency facility for amortization purposes is the unadjusted basis for amortization purposes less the adjustments properly applicable thereto. Such adjustments are those specified in section 113 (b), except that no adjustments are to be taken into account which increase the adjusted basis. (See paragraph (b) of this section.) Amounts received by a taxpayer in connection with its agreement to supply articles for national defense, though denominated reimbursements for all or a part of the cost of an emergency facility, are not to be treated as capital receipts but are to be taken into account in computing income, and are therefore not to be applied in reduction of the basis of such facility. The following examples will illustrate the computation of the adjusted basis of an emergency facility for amortization purposes:

Example (1). The X Corporation completes an emergency facility on July 1, 1940, the entire unadjusted basis of which is $500,000 and the unadjusted basis of which for purposes of amortization is $300,000. The X Corporation elects to begin amortization on January 1, 1941. The only adjustment to basis for the period from July 1, 1940, to January 31, 1941, other than depreciation or amortization for January 1941, is $5,000 for depreciation for the last six months of 1940. The adjusted basis for purposes of amortization is therefore $300,000 less $3,000 (300,000/500,000ths of $5,000), or $297,000.

Example (2). On July 31, 1944, the Y Corporation has an emergency facility (a building) completed on July 1, 1940, the entire unadjusted basis of which is $500,000, and the unadjusted basis of which for purposes of amortization is $300,000. The corporation elects to begin amortization on January 1, 1941, by which time it is entitled to $5,000 depreciation for the last six months of 1940. On July 1, 1944, the facility is damaged by fire, as the result of which its adjusted basis is properly reduced by $200,000. The adjusted bases of the emergency facility as of July 1944 for purposes of amortization and depreciation, and the adjusted basis for other purposes, are $23,849.18, $49,250.82, and $73,100, respectively, computed as follows:

	For amortization	For depreciation	For other purposes
Unadjusted basis	$300,000.00	$200,000.00	$500,000
Less depreciation to January 1, 1941	3,000.00	2,000.00	5,000
Adjusted basis January 1941	297,000.00	198,000.00	495,000
Less amortization for 42 months	207,900.00	None	207,900
Less depreciation for 42 months	None	14,000.00	14,000
Adjusted basis at time of fire loss	89,100.00	184,000.00	273,100
Less fire loss (apportioned as explained below)	65,250.82	134,749.18	200,000
Adjusted basis after fire loss	23,849.18	49,250.82	73,100

The $200,000 fire loss is applied against the adjusted basis for purposes of amortization and the adjusted basis for purposes of depreciation in the proportion that each such adjusted basis at the time of such fire loss bears to their sum, i. e., 89,100/273,100ths of $200,000 or $65,250.82, against the amortization basis, and 184,000/273,100ths of $200,000 or $134,749.18, against the depreciation basis.

(b) *Capital additions.* If, after the completion or acquisition of an emergency facility with respect to which a certificate of necessity has been made, further expenditures are made for construction, reconstruction, erection, installation, or acquisition attributable to such facility but not included in such certificate of necessity, such expenditures shall not be added to the adjusted basis of the emergency facility for amortization purposes under such certificate. If such further expenditures are covered by a separate certificate of necessity made in accordance with the provisions of section 124 (f), they are treated as certified expenditures in connection with a new emergency facility, and, if proper election is made, will be taken into account in computing the adjusted basis of such new emergency facility for purposes of amortization.

Example. On March 1, 1942, the Secretary of the department concerned certifies as an emergency facility a heating plant proposed to be constructed by the Z Corporation. Such facility is completed on July 1, 1942. The Z Corporation, on August 1, 1942, begins the installation in the plant of an additional boiler, which is not included in the certificate for the plant but is, prior to such installation, certified in a separate certificate as necessary in the interest of national defense. For amortization purposes, the adjusted basis of the heating plant is determined without including the cost of the additional boiler. Such cost is taken into account in computing the adjusted basis of the new emergency facility (the boiler), as to which the taxpayer has a separate election for amortization purposes and a separate amortization period.

§ 29.124–7 *Depreciation of portion of emergency facility not subject to amortization.* The rule set forth in section 124 (a) (see § 29.124–2), that an amortization deduction with respect to an emergency facility is in lieu of any deduction for depreciation which would otherwise be allowable with respect to such facility, is subject to the exception provided in section 124 (g). Under this exception, if the property constituting such facility is depreciable property under section 23 (l) and the regulations pertaining thereto and if the adjusted basis of such facility as computed under section 113 (b) for purposes other than the amortization deductions (see § 29.113 (b) (1)–1) is in excess of the adjusted basis computed under section 124 (f) for purposes of the amortization deductions (see § 29.124–6), then the excess shall be charged off over the useful life of the facility and recovered through depreciation deductions. Thus, if the construction of an emergency facility is begun on or before December 31, 1939, and completed after such date, no amortization deductions are allowable with respect to the amount attributable to such construction on or before such date (see § 29.124–6). However, if the property constituting such facility is depreciable property under section 23 (l) and the regulations pertaining thereto, then the depreciation deduction provided by such section and regulations is allowable with respect to the amount attributable to such construction on or before December 31, 1939.

Similarly, if only a part of the construction, reconstruction, erection, installation, or acquisition after December 31, 1939, of an emergency facility has been certified by the Secretary of the department concerned as necessary in the interest of national defense during the emergency period, and if such facility is depreciable property under section 23 (l) and the regulations pertaining thereto, then the depreciation deduction provided by such section and regulations is allowable with respect to the part which has not been so certified.

For illustration of the treatment of a depreciable portion of an emergency facility, see example (2) in § 29.124–6 (a).

§ 29.124–8 *Payment by United States of unamortized cost of facility.* Section 124 (h) contemplates that certain payments may be made by the United States to a taxpayer as compensation for the unamortized cost of an emergency facility. If the amount of any such payment is properly includible in gross income and has been certified, as provided in section 124 (h), as having been paid under the circumstances described therein, a taxpayer which is recovering the adjusted basis of an emergency facility through amortization rather than depreciation may elect to take such amount as an amortization deduction with respect to such facility for the month in which such amount is so includible. Such amortization deduction shall be in lieu of the amortization deduction otherwise allowable with respect to such facility for such month, and shall not in any case exceed the adjusted basis of such facility (see § 29.124–6), as of the end of such month (computed without regard to any amortization deduction for such month). The election referred to in this paragraph shall be made in the return for the taxable year in which the amount of such payment is includible in gross income.

If a taxpayer is recovering the adjusted basis of an emergency facility through depreciation rather than amortization, the depreciation deduction allowable under section 23 (l) for the month in which the amount of any such payment is includible in gross income shall, at the taxpayer's election, be increased by such amount; but the total deduction with respect to the certified portion of such facility shall not in any case exceed the adjusted basis of such facility (computed as provided in section 124 (f) and § 29.124–6 for amortization purposes) as of the end of such month (computed without regard to any amount allowable for such month under section 23 (l) or 124 (h) (2)). The election referred to in this paragraph shall be made in the return for the taxable year in which the amount of such payment is includible in gross income.

This section may be illustrated by the following examples:

Example (1). On January 31, 1942, the X Corporation purchases an emergency facility at a cost of $600,000. The certificate of necessity covers the entire acquisition. The X Corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with February 1942, the month following the month of acquisition. On July 15, 1943, as a result of the cancellation of certain contracts with the X Corporation, the United States makes a payment of $300,000 to the corporation as compensation for the unamortized cost of such facility. The $300,000 payment is includible in the X Corporation's gross income for July 1943. The adjusted basis of such facility for amortization purposes as of the end of July 1943, computed without regard to any amortization deduction for such month, is $430,000. Accordingly, the corporation is entitled to take an amortization deduction of $300,000 for such month, in lieu of the $10,000 amortization deduction which is otherwise allowable.

Example (2). On November 30, 1942, the Y Corporation purchases an emergency facility, consisting of land with a building thereon at a cost of $500,000 of which $200,000 is allocable to the land and $300,000 to the building. The certificate of necessity covers the entire acquisition. The Y Corporation does not elect to take amortization deductions with respect to such facility, but is entitled to a depreciation deduction with respect to the building at the rate of 3 percent per annum, or $750 per month. On August 12, 1944, as a result of cancellation of certain contracts, the United States makes a payment of $400,000 to the corporation as compensation for the unamortized cost of such facility. The $400,000 is includible in the Y Corporation's gross income for August 1944. The adjusted basis of the facility as of the end of August 1944, computed without regard to depreciation for such month, is $485,000, of which amount $200,000 is allocable to the land and $285,000 to the building. Accordingly, the corporation is entitled to increase the $750 depreciation deduction for August 1944 by the full amount of the $400,000 payment.

§ 29.124–9 *Life tenant and remainderman.* In the case of an emergency facility held by one person for life with remainder to another person, the amortization deduction shall be computed as if the life tenant were the absolute owner of the facility and shall be allowable to the life tenant during his life.

SEC. 125. AMORTIZABLE BOND PREMIUM [as added by sec. 126 (b), Rev. Act 1942].

(a) *General rule.* In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond for any taxable year beginning after December 31, 1941:

(1) *Interest wholly or partially taxable.* In the case of a bond (other than a bond the interest on which is excludible from gross income), the amount of the amortzable bond premum for the taxable year shall be allowed as a deducton.

(2) *Interest wholly tax-exempt.* In the case of any bond the interest on which is excludible from gross income, no deduction shall be allowed for the amortizable bond premium for the taxable year.

(3) *Adjustment of credit in case of interest partially tax-exempt.* In the case of any bond the interest on which is allowable as a credit against net income, the credit provided in section 25 (a) (1) or (2), or section 26 (a), as the case may be, shall be reduced by the amount of the amortizable bond premium for the taxable year.

(For adjustment to basis on account of amortizable bond premium, see section 113 (b) (1) (H)).

(b) *Amortizable bond premium*—(1) *Amount of bond premium.* For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determning loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date, with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

(2) *Amount amortizable.* The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

(3) *Method of determination.* The determinations required under paragraphs (1) and (2) shall be made—

(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) in all other cases, in accordance with regulations prescribing reasonable methods of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary.

(c) *Election on taxable and partially taxable bonds*—(1) *Eligibility to elect and bonds with respect to which election permitted.* This section shall apply with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer has elected to have this section apply.

(A) *Partially tax exempt.* In the case of a taxpayer other than a corporation, bonds with respect to the interest on which the credit provided in section 25 (a) (1) or (2) is allowable; and

(B) *Wholly taxable.* In the case of any taxpayer, bonds the interest on which is not excludible from gross income but with respect to which the credit provided in section 25 (a) (1) or (2), or section 26 (a), as the case may be, is not allowable.

(2) *Manner and effect of election.* The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner with the approval of the Secretary shall prescribe. If such election is made with respect to any bond (described in paragraph (1)) of the taxpayer, it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies and to all such bonds thereafter acquired by him and shall be binding for all subsequent taxable years with respect to all such bonds of the taxpayer, unless, upon application by the taxpayer, the Commissioner permits him, subject to such conditions as the Commissioner deems necessary, to revoke such election. The election authorized under this subsection in the case of a member of a partnership shall be exercisable with respect to bonds of the partnership only by the partnership. In the case of bonds held by a common trust fund, as defined in section 169, or by a foreign personal holding company, as defined in section 331, the election authorized under this subsection shall be exercisable with respect to such bonds only by the common trust fund or foreign personal holding company.

(d) *Definition of bond.* As used in this section, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof), with interest coupons or in registered form, but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

§ 29.125–1 *In general*—(a) *Application.* Section 125 makes provision for the amortization of bond premium by the owners of the bonds. It is mandatory with respect to:

(1) Fully tax-exempt bonds (the interest on which is excludible from gross income), whether the owner is a corporation, individual, or other taxpayer; and

(2) Partially tax-exempt bonds (the interest on which is subject only to surtax) owned by a corporation.

It is optional, at the election of the taxpayer, with respect to:

(1) Fully taxable bonds (the interest on which is subject to normal tax and surtax), whether the owner is a corporation, individual, or other taxpayer; and

(2) Partially tax-exempt bonds owned by taxpayers other than corporations.

The term "bond" as used in section 125 means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof), with interest coupons or in registered form, but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Since bonds owned by dealers in securities are excluded from the foregoing definition, section 125 has no application to such dealers.

(b) *Operation.* In the case of a fully tax-exempt bond, the amortizable bond premium for the taxable year is simply an adjustment to the basis or adjusted basis of the bonds. Thus, if such premium is $1, the basis or adjusted basis of the bond is reduced by $1. No deduction is allowable on account of such amortizable bond premium. In the case of a fully taxable bond to which section 125 is applicable, the amortizable bond premium is both an adjustment to the basis or adjusted basis of the bond and a deduction.

In the case of a partially tax-exempt bond to which such section is applicable, the amortizable bond premium for the taxable year is used for three purposes: (1) As an adjustment to the basis or adjusted basis of the bond; (2) as a deduction; and (3) as a reduction of the credit for the interest on the bond, provided in section 25 (a) (1) or (2), or section 26 (a). Accordingly, if the interest on such a partially tax-exempt bond for the taxable year is $30 and the amortizable bond premium thereon for such taxable year is $5, the $30 is included in gross income, the $5 is allowable as a deduction, an adjustment in the amount of $5 is made to the basis or adjusted basis of the bond, and the credit on account of such interest is $25 ($30 minus $5).

In the case of a trust the income of which is distributable to the beneficiaries in whole or in part, where the trustee elects to amortize bond premium by deducting the amount thereof in the return filed for the trust on Form 1041, the distributable income of the trust determined in accordance with the provisions of section 162 (b) is the full amount otherwise distributable without reduction for amortization of bond premium in all cases where, under the law applicable to the trust or under the provisions of the trust instrument, the income distributable to the beneficiaries shall not be reduced by such reduction for amortization. (See section 24 (d).)

§ 29.125–2 *Bond premium and amortizable bond premium.* Bond premium on any bond to which section 125 applies is the excess of the amount of the basis (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date. (For determination of applicable call date see § 29.125–5.) If the date as of which such basis of the bond was established precedes the first taxable year with respect to which such section applies to the bond, there shall be made adjustments proper to reflect unamortized bond premium on such bond for the period including the holding period (as determined under section 117 (h)) prior to the date as of which section 125 first becomes applicable to the bond in the hands of the taxpayer. The application of the preceding sentence relating to adjustments may be illustrated by the following examples:

Example (1). On January 1, 1942, T, who makes his income tax returns on the calendar year basis, owns a fully taxable $100 bond, maturing on January 1, 1952. T purchased this bond on January 1, 1932, for $120. T elects to have section 125 apply to such bond for 1942 and subsequent taxable years. In determining the amount of bond premium to be amortized over the remaining 10 years of the life of the bond, T is required, but solely for such purpose, to treat the bond as if he had amortized the bond premium thereon during the prior 10 years under this section, and to make the proper adjustment in the original bond premium. Accordingly, T would treat $10 as having been amortized during the first 10 years and would be required to amortize the remaining $10 over the following 10 years. When the bond is redeemed on January 1, 1952, for $100, only the $10 attributable to the second 10 years will actually have been amortized. The $10 attributable to the first 10 years will have been treated as an adjustment to the original bond premium but will not have been amortized. Consequently T will have a capital loss in the year of redemption on account of the $10 attributable to the period 1932–1942.

Example (2). On January 1, 1942, X's father gave him a fully taxable $100 bond maturing on January 1, 1952. X's father had purchased the bond on January 1, 1932, for $120. The fair market value of the bond at the time of the gift was $130. X makes his income tax returns on the calendar year basis and elects to amortize the bond premium on the bond during the period from 1942 to 1952. Under section 113 (a) (2) the cost of the bond to X's father constitutes the basis of the bond in X's hands for determining loss, since such cost is lower than the fair market value of

the bond at the time of the gift, and under section 117 (h) (2) X's holding period is deemed to include the 10 years during which his father held the bond. X is required to treat the bond as if the bond premium thereon had been amortized during his father's holding period. Thus, X is required to amortize $10 over the period 1942–1952 and in the year of redemption will have a capital loss on account of the $10 attributable to his father's holding period.

Example (3). On January 1, 1942, Y, who makes his income tax returns on the calendar year basis, owns a tax-exempt $100 bond, maturing on January 1, 1951. He purchased this bond on January 1, 1941, for $110. On December 31, 1944, Y sells the bond for $108 and thus realizes a gain of $1, computed as follows:

(1) Total bond premium ($110 minus $100)	$10
(2) Amount of bond premium amortization under section 125 (total bond premium minus unamortized bond premium attributable to 1941, $10 minus $1)	9
(3) Amount of bond premium amortized from January 1, 1942, through December 31, 1944 ($1 for each such year)	3
(4) Adjusted basis of bond at close of 1944 ($110 minus $3)	107
(5) Gain ($108 minus $107)	1

Amortizable bond premium on any bond to which section 125 applies is such part of the bond premium on the bond as is attributable to the taxable year.

§ 29.125–3 *Methods of amortization.* The determinations of the bond premium and amortizable bond premium on any bond to which section 125 applies shall be made in accordance with:

(a) The method of amortization regularly employed by the taxpayer, if such method is reasonable; or

(b) The method of amortization prescribed by this section.

A method of amortization will be deemed "regularly employed" by a taxpayer if the method was consistently followed in taxable year beginning prior to January 1, 1942, or if for taxable years beginning on or after such date the taxpayer (including a taxpayer who followed a different method in taxable years beginning prior to January 1, 1942) initiates in the first taxable year for which the deduction is taken a reasonable method of amortization and consistently follows such method thereafter. A taxpayer who regularly employs a method of amortization may be one, for example, who is subject to the jurisdiction of a State or Federal regulatory agency and who, for the purposes of such agency, amortizes the bond premium on his bonds in accordance with a method prescribed or approved by such agency. However, it is not necessary that the taxpayer be subject to the jurisdiction of such an agency or that the method be prescribed or approved by such agency. It is sufficient if the taxpayer regularly employs a method of amortization and if such method is reasonable.

The method of amortization prescribed by this section is as follows:

(1) The bond premium on any bond to which section 125 applies shall be determined in accordance with § 29.125–2 and shall be computed as of the end of the taxable year (or as of the date of disposition or redemption of the bond, if it was disposed of or redeemed in the taxable year) but without regard to the amortizable bond premium for the taxable year; and

(2) The amortizable bond premium on such bond for the taxable year shall be an amount which bears the same ratio to the bond premium on the bond as the number of months in the taxable year during which the bond was owned by the taxpayer bears to the number of months from the beginning of the taxable year (or, if the bond was acquired in the taxable year, from the date of acquisition) to the date of maturity or earlier call date. For the purposes of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

§ 29.125–4 *Election.* In the case of a corporation, the election provided in section 125 may be made only with respect to fully taxable bonds. In the case of a taxpayer other than a corporation, the election provided in such section may be made with respect to (a) fully taxable bonds only, or (b) partially tax-exempt bonds only, or (c) both fully taxable bonds and partially tax-exempt bonds. Such election shall be made by the taxpayer by claiming a deduction for the bond premium in his return for the first taxable year to which he desires the election to be applicable. No other method of making such election is permitted. If the election is so made, the taxpayer should attach to his return a statement showing the computation of the deduction. The election shall apply to all bonds in respect of which it was made owned by the taxpayer at the beginning of the first taxable year to which the election applies and also to all bonds of such class (or classes) thereafter acquired by him, and shall be binding for all subsequent taxable years. Upon application by the taxpayer, the Commissioner may permit him to revoke the election, subject to such conditions as the Commissioner deems necessary. In the case of bonds owned by a partnership, common trust fund, or foreign personal holding company, the election shall be exercisable by such partnership, common trust fund, or foreign personal holding company.

§ 29.125–5 *Callable and convertible bonds.* The fact that a bond is callable or convertible into stock does not, in itself, prevent the application of section 125. For the purposes of such section, in the case of a callable bond the earlier call date will be considered as the maturity date and the amount due on such date will be considered as the amount payable on maturity, unless the taxpayer regularly employs a different method of amortization which is reasonable. Hence, the bond premium on such a bond is required to be spread over the period from the date as of which the basis for loss of the bond is established down to the earlier call date, rather than the maturity date. The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer. A taxpayer who deducts amortizable bond premium with reference to a particular call date may not thereafter use a different call date in the calculation of amortization deductions with respect to such premium. A convertible bond is within the scope of section 125 if the option to convert on a date certain specified in the bond rests with the holder thereof.

§ 29.125–6 *Capitalized expenses.* In the case of a bond on which there is no bond premium exclusive of capitalized expenses (such as buying commissions), but to which section 125 otherwise applies, a taxpayer who is required by these regulations to use the method of amortization prescribed by § 29.125–3, a taxpayer who regularly employs a reasonable method of amortization under which such capitalized expenses are amortized, or a taxpayer who regularly employs a reasonable method of amortization under which such capitalized expenses are not amortized, is permitted but not required, to amortize such capitalized expenses in accordance with such method.

In the case of a bond to which section 125 applies and on which there is bond premium exclusive of capitalized expenses, a taxpayer who is required by these regulations to use the method of amortization prescribed by § 29.125–3, must treat capitalized expenses as being part of the bond premium for the purposes of section 125, or if the taxpayer regularly employs a reasonable method of amortization under which such capitalized expenses are treated as being part of the bond premium for the purposes of amortization, such capitalized expenses must be treated as being part of the bond premium for the purposes of section 125, but if under such regularly employed method such capitalized expenses are not treated as being part of the bond premium for the purposes of amortization, the taxpayer may, but is not required to treat such capitalized expenses as being part of the bond premium for the purposes of section 125.

§ 29.125–7 *Taxable years in which interest not received or accruable.* In the case of a taxpayer who makes his income returns on the cash receipts and disbursements basis or one who makes his returns on the accrual basis and who owns a bond to which section 125 applies and in respect of which no interest is received or accrued by the taxpayer during the taxable year, if the taxpayer is required by these regulations to use the method of amortization prescribed by § 29.125–3, or if the taxpayer regularly employs a reasonable method of amortization under which the bond premium on such bond for such taxable year is amortized, or if the taxpayer regularly employs a reasonable method of amortization under which the bond premium on such bond for such taxable year is not amortized, amortization of bond premium on such bond for such taxable

year is not required, but will be permitted in accordance with such method.

§ 29.125–8 *Bonds owned by decedents*—(a) *Cash basis decedents.* If a decedent on the cash receipts and disbursements basis owned fully taxable bonds and partially tax-exempt bonds to which section 125 applies:

(1) In the case of a fully taxable bond, the interest accruing thereon during the period ending with his death is, by reason of section 126, included upon its receipt in the gross income of the estate or legatee, whichever acquires the right to receive such interest, while the deduction on account of amortizable bond premium for such period is properly allowable as a deduction for such period under the decedent's method of accounting and is not allowable as a deduction for the estate or legatee; and

(2) In the case of a partially tax-exempt bond:

(i) The interest accruing thereon for such period is similarly included upon its receipt in the gross income of the estate or legatee, as the case may be;

(ii) The estate's or legatee's credit for such interest is not reduced on account of the amortizable bond premium for such period; and

(iii) The deduction on account of the amortizable bond premium for such period is allowable as a deduction in the return for the decedent as in the case of a fully taxable bond.

The application of the foregoing provisions relating to a partially tax-exempt bond may be illustrated by the following example:

Example. At the time of his death in 1942, D owns a partially tax-exempt bond to which section 125 applies. For the period beginning January 1, 1942, and ending with his death, the accrued interest on such bond is $25 and the amortizable bond premium is $2. D's estate has the right to receive such interest. D's executor, in making the income tax return for such period, may take into account a deduction in the amount of $2 on account of the amortizable bond premium for such period. D's estate includes the interest ($25) in its gross income upon receipt and, for the purposes of the normal tax, receives a credit for $25, which is not reduced on account of the amortizable bond premium which was a deduction allowable for the last taxable period of the decedent.

(b) *Accrual basis decedents.* If a decedent on the accrual basis owns fully taxable bonds and partially tax-exempt bonds to which section 125 applies:

(1) In the case of a fully taxable bond, both the interest accruing thereon during the period ending with his death and the deduction on account of the amortizable bond premium for such period is allowable as a deduction in the return for the decedent; and

(2) In the case of a partially tax-exempt bond, the rule as to the accrued interest and the amortization deduction is the same as in (1) above, and his credit for such interest is required to be reduced by the amount of the amortizable bond premium for the period ending with the decedent's death.

§ 29.125–9 *Partially tax-exempt bonds owned by estates, trusts, partnerships, etc.* If a trust owning partially tax-exempt bonds elects to amortize the bond premium thereon under section 125, the credits of the trust and the beneficiaries on account of such interest are required to be reduced by the portion of the amortization deduction attributable to their shares of such interest. A similar rule is applied in the case of partially tax-exempt bonds owned by estates, common trust funds, partnerships, foreign personal holding companies, and personal service corporations.

SEC. 126. INCOME IN RESPECT OF DECEDENTS. [as added by sec. 134 (e), Rev. Act 1942].

(a) *Inclusion in gross income*—(1) *General rule.* The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

(2) *Income in case of sale, etc.* If a right, described in paragraph (1), to receive an amount is transferred by the estate of the decedent or a person who receives such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For the purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, but does not include a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

(3) *Character of income determined by reference to decedent.* The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right; and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

(b) *Allowance of deductions and credit.* The amount of any deduction specified in section 23 (a), (b), (c), or (m) (relating to deductions for expenses, interest, taxes, and depletion) or credit specified in section 31 (foreign tax credit), in respect of a decedent which is not properly allowable to the decedent in respect of the taxable period in which falls the date of his death, or a prior period, shall be allowed:

(1) *Expenses, interest, and taxes.* In the case of a deduction specified in section 23 (a), (b), or (c) and a credit specified in section 31, in the taxable year when paid—

(A) to the estate of the decedent; except that

(B) if the estate of the decedent is not liable to discharge the obligation to which the deduction or credit relates, to the person who, by reason of the death of the decedent or by bequest, devise, or inheritance acquires, subject to such obligation, from the decedent an interest in property of the decedent.

(2) *Depletion.* In the case of the deduction specified in section 23 (m), to the person described in subsection (a) (1) (A), (B), or (C) who, in the manner described therein, receives the income to which the deduction relates, in the taxable year when such income is received.

(c) *Deduction for estate tax*—(1) *Allowance of deduction.* A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a) (1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a) (1).

(2) *Method of computing deduction.* For the purposes of paragraph (1):

(A) The term "estate tax" means the tax imposed upon the estate of the decedent under section 810 or 860, reduced by the credits against such tax, plus the tax imposed upon the estate of the decedent under section 935, reduced by the credits against such tax.

(B) The net value for estate tax purposes of all the items described in subsection (a) (1) shall be the excess of the value for estate tax purposes of all the items described in subsection (a) (1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b).

(C) The estate tax attributable to such net value shall be an amount equal to the excess of the estate tax over the estate tax computed without including in the gross estate such net value.

§ 29.126–1 *Inclusion in gross income of income in respect of a decedent.* The gross income for the taxable year of a decedent beginning on or after January 1, 1943, in which falls the date of his death, is computed upon the basis of the method of accounting followed by such decedent, even though amounts to which he is entitled as gross income are not includible under such method in computing net income for such taxable year or any prior taxable year. See § 29.42–1. Such amounts include all the accrued income of a decedent who reported his income on the basis of cash receipts and disbursements, and, in the case of a decedent who reported his income under the accrual method of accounting, such amounts include contingent items which were not accrued by the decedent and, under § 29.42–1, all items (except the amount of partnership income includible under section 182) which were accrued in the last taxable year of the decedent solely by reason of his death. For example, if the decedent who reported income on the basis of the accrual method of accounting was a member of a partnership which kept its books on the basis of cash receipts and disbursements, the decedent would be entitled at the date of his death to his distributive share of the accrued income of the partnership, although there would be included in his gross income only his distributive share

of the partnership income computed on the basis of cash receipts and disbursements. Furthermore, if his partnership agreement had provided for the sale to the other partners upon his death of his right to the partnership assets in return for a payment of a certain sum by the surviving partners to his estate, the gain on such sale, accrued solely by reason of his death, would not be included in computing his net income.

Under section 126 (a) (1), all such amounts to which a decedent is entitled as gross income and which are not includible in computing his net income for his last taxable year or any prior taxable year shall be included, when received, in the gross income of the estate of the decedent or of the person receiving such amounts if such amounts are received in a taxable year ending after December 31, 1942, by the estate of the decedent or by a person entitled to such amounts by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent. These amounts are included in the income of the estate and such persons when received by them, regardless of whether or not they report income on the basis of cash receipts and disbursements.

The persons who are placed with respect to such amounts in the same position as the decedent are the decedent's estate (which in the great majority of cases will be the one who receives such amounts) and, if the estate does not collect such amounts but distributes the right to receive such amounts to the heir, next of kin, legatee, or devisee who inherited or was bequeathed or devised such right, such heir, next of kin, legatee or devisee. Thus, if the decedent who kept his books on the basis of cash receipts and disbursement was entitled at the date of his death to a large salary payment to be made in equal annual installments over five years, and his estate after collecting two installments distributed the right to the remaining installment payments to the residuary legatee of the estate, the estate must include in its gross income the two installments received by it, and the legatee must include in his gross income each of the three installments received by him.

Also placed in the same position as the decedent with respect to such amounts are those who acquire the right to such amounts by reason of the death of the decedent. An example of the application of this provision is the case of a decedent who owned a defense bond, with his wife as coowner or beneficiary, and who died before the payment of such bond. The entire amount accruing on the bond and not includible in income by the decedent, not just the amount accruing after the death of the decedent, would be treated as income to his wife when the bond is paid. Another example is the case of a partner whose partnership agreement provided that upon his death his interest in certain partnership assets would pass to the surviving partners in exchange for payments to be made by them to his widow. Upon his death, the payments by the surviving partners must be included in the widow's income to the extent they exceed the adjusted basis of such assets in the hands of the decedent immediately prior to his death. This gain was not includible in the partner's income since it was not received by the partner (for the purposes of the cash receipts and disbursements method of acounting) and was accrued only by reason of his death (for the purposes of the accrual method of accounting). If the payments are to be made to the widow as trustee for minor children, and if the right to receive such payments is transferred to the children upon their majority, the children are within the provisions of section 126 (a) (1) as receiving the right to such payments by reason of the death of the decedent, and must include such payments when received in their income to the extent the payments represent the gain on the sale.

Since section 126 provides for the treatment of such amounts as income to the estate and other persons placed in the same position as the decedent with respect to such amounts, the provisions of section 113 (a) (5) with respect to the basis of property acquired by bequest, devise, or inheritance do not apply to these amounts in the hands of the estate and such persons. Furthermore, section 126 only applies to the amount of items of gross income in respect of a decedent, and items which are excluded from his gross income under section 22 (b) or section 116 are not within the provisions of section 126.

If the right to receive an amount of income in respect of a decedent is transferred by the estate or the person entitled to such amount by bequest, devise, or inheritance, or by reason of the death of the decedent, the fair market value of such right at the date of the transfer shall be included in the income of the estate or of such person, plus the amount by which any consideration received on such transfer exceeds the fair market value of such right. Thus, upon a sale of such right, the fair market value of the right or the amount received upon the sale, whichever is greater, is included in income. Similarly, if the right to receive the income is disposed of, as by gift or bequest, the fair market value of such right at the time of such disposition must be included in the gross income of the donor, testator, or other transferor. However, if the person to whom such right is transferred is a person described in section 126 (a) (1) as being entitled to such right by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent, such fair market value of the right is not included in the income of the transferor. Examples of such transfers are those by the estate to a specific legatee of such right or to the residuary legatee. Another example is the case of a trust to which is bequeathed the right of the decedent to certain payments of income. If the trust terminates and the right to such payments is transferred to the beneficiary, the trust does not include the fair market value of the right to receive such payments in its income, but such payments are included in the income of the beneficiary under the provisions of section 126 (a) (1). Under section 126 (a) (1), the transferee in each of the above examples must include the amount, when received, in his income, and if he transfers the right to receive such amount to a person not entitled to such right by bequest, devise, or inheritance from the decedent or by reason of his death, then he must include in his income the fair market value of the right at the time of such transfer.

The right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate or the person entitled to receive such amount by bequest, devise, or inheritance from the decedent or by reason of his death as if it had been acquired in the transaction by which the decedent acquired such right, and shall be considered as having the same character it would have had if the decedent had lived and received such amount. The estate or such person is placed in the same position with respect to the nature of this income as the position the decedent enjoyed. Thus, if the income would have been capital gain to the decedent, if he had lived and had received it, from the sale of property held for more than six months, the income when received, or its fair market value if transferred, shall be treated in the hands of the estate or of such person as gain from the sale of the property, held for more than 6 months, in the same manner as if such person had held the property for the period the decedent held it, and had made the sale. Similarly, if the income is interest on United States obligations owned by the decedent, such income shall be treated as interest on United States obligations in the hands of the person receiving it, for the purpose of determining the credit provided by section 25 (a) (1) and (2), as if such person owned the obligations with respect to which such interest is paid. If the amount would have constituted earned income to the decedent, as in the case of the accrued wages of a decedent who reported income on the basis of cash receipts and disbursements, such amount shall constitute earned income to the person including such amount in his gross income to the same extent as if he had engaged in place of the decedent in the transaction in which the amount was earned. Such earned income would be included with the other earned income of such person, in determining his earned income credit, and such aggregate would of course be subject to the limitations on such credit. The estate is not allowed any credit for such income which is treated as earned income in its hands, since there is no provision in Supplement E (sections 161 to 172, inclusive) allowing such a credit in the case of an estate. If the amounts are compensation for personal services rendered over a period of 36 months or more, and would be within the provisions of section 107 if the decedent had lived and included such amounts in his gross income, section 107 applies. That is, the tax attributable to the inclusion of this amount in the gross income of the person receiving it shall not exceed the aggregate of the taxes of the decedent which would be attributable to such amount if it had been received by the decedent in equal portions in each

of the months included in the period in which the personal services were rendered. Similarly, the provisions of sections 105 and 106, relating to the tax attributable to the sale of certain oil or gas property and to certain claims against the United States, apply to any amount included in gross income, the right to which was obtained by the decedent by a sale or claim within the provisions of those sections. The tax attributable to the inclusion of this amount in the gross income of the person receiving it shall not exceed 30 percent of such amount.

§ 29.126–2 *Allowance of deductions and credit in respect of decedent.* Under section 126 (b), the expenses, interest, and taxes described in section 23 (a), (b), and (c) for which the decedent, dying in a taxable year beginning after December 31, 1942, was liable, which were not properly allowable as a deduction in his last taxable year or any prior taxable year, are allowed when paid (a) as a deduction by the estate, or (b) if the estate was not liable to pay such obligation, as a deduction by the person who by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent acquires subject to such obligation an interest in property of the decedent. Similar treatment is given to the foreign tax credit provided by section 31. For the purposes of (b) above, the right to receive an amount of gross income in respect of a decedent is considered property of the decedent; on the other hand, it is not necessary for a person, otherwise within the provisions of (b), to receive the right to any income in respect of a decedent. Thus, if the right to income in respect of a decedent, receivable by reason of the death of the decedent by a person other than the estate, is subject to an income tax imposed during the life of the decedent by a foreign country, which tax must be satisfied out of such income, such person is entitled to the credit provided in section 31 when he pays this obligation. If the decedent, who reported income on the basis of cash receipts and disbursements, owned real property on which no income had accrued, but on which accrued taxes had become a lien, and if such property passed directly to the heir of the decedent in a jurisdiction in which real property does not become a part of a decedent's estate, the heir, upon paying such taxes, may take the same deduction under section 23 (c) that would be allowed to the decedent if, while alive, he had made such payments.

However, the deduction for percentage depletion is allowable only to the person who receives the income in respect of the decedent to which the deduction relates, whether or not such person receives the property from which such income is derived. Thus, if the income results from payments on units of mineral sold by the decedent, who reported income on the basis of cash receipts and disbursements, the deduction for depletion, computed on such number of units as if the person receiving such income had the same economic interest as the decedent, shall be allowed to such person regardless of whether or not he receives any interest in the mineral property other than such income. If the decedent did not compute his deduction for depletion on the basis of percentage depletion, any deduction for depletion to which the decedent was entitled at the date of his death would be allowable in computing his net income for his last taxable year, and there can be no deduction in respect of the decedent by any other person for such depletion.

§ 29.126–3 *Deduction for estate tax attributable to income in respect of decedent.* Section 126 (c) provides that the estate or person required to include in gross income any amount in respect of a decedent may deduct that portion of the estate tax on the decedent's estate which is attributable to the inclusion in the decedent's estate of the right to receive such amount. This deduction is determined by first ascertaining the net value in the decedent's estate of the items which are included under section 126 in computing the income of the persons described in that section, that is, the excess of the value included in the gross estate on account of the items of gross income in respect of the decedent over the deductions from the gross estate for claims which represent the deductions and credit in respect of the decedent described in section 126 (b). The portion of the estate tax (the sum of the basic estate tax and the additional estate tax, reduced by the credits against such taxes) attributable to the inclusion in the gross estate of such net value is the excess of the estate tax over the estate tax computed without including such net value in the gross estate. The estate and each person receiving income in respect of the decedent may deduct as his share of such portion of the estate tax an amount which bears the same ratio to such portion as the value in the gross estate of the right to the income included by the estate or such person in gross income bears to the value in the gross estate of all the items of gross income in respect of the decedent. Section 126 (c) is illustrated by the following example:

Example. X, an attorney who kept his books on the basis of the cash receipts and disbursements method of accounting, was entitled at the date of his death to a fee for services rendered in a case not completed at the time of his death, which fee was valued in his estate at $1,000, and to accrued interest on bonds which was valued at $500. In all, $1,500 was included in his gross estate in respect of income described in section 126 (a) (1). There were deducted as claims against his estate $150 for business expenses for which his estate was liable, and $50 for taxes accrued on certain property he owned, in all $200, for claims which represent the deductions described in section 126 (b) which are allowable as deductions to his estate or to the beneficiaries of his estate. His gross estate is $185,000 and his net estate, computed without deducting any specific exemption, is $170,000, on which the total basic and additional estate tax (reduced by credits against such tax) is $23,625. In the year following the death of X, his estate collected the fee in the amount of $1,200, which amount is included in the income of the estate. The estate may deduct, in computing its net income for such year, $260 on account of the estate tax attributable to such income, computed as follows:

(a) (1)	Value of income described in section 126 (a) (1) included in computing gross estate	$1,500
(2)	Deductions in computing gross estate for claims representing deductions described in section 126 (b)	200
(3)	Net value of items described in section 126 (a) (1)	1,300
(b) (1)	Estate tax (basic and additional estate taxes, less credits against such taxes)	23,625
(2)	Less: Estate tax computed without including $1,300 (item (a) (3) above) in gross estate	23,235
(3)	Portion of estate tax attributable to net value of income items	23,390
(c) (1)	Value in gross estate of income received by estate in taxable year	1,000
(2)	Value in gross estate of all income items described in section 126 (a) (1) (item (a) (1) above	1,500
(3)	Part of estate tax deductible upon receiving the $1,200 fee $\left(\frac{1,000}{1,500}\text{ of }\$390\right)$	260

Although $1,200 was later collected as the fee, only the $1,000 actually included in the gross estate is used in the above computations. However, to avoid distortion, section 126 (c) provides that if the value included in the gross estate is greater than the amount finally collected, only the amount collected shall be used in the above computations. Thus, if the amount collected as the fee were only $500, the estate tax deductible on the receipt of such amount would be $\frac{500}{1,500}$ of $390 or $130.

§ 29.126–4 *Income in respect of decedent dying in taxable year beginning before 1943; tax of decedent*—(a) *In general.* If the last taxable year of the decedent began before January 1, 1943, then under the law applicable to such taxable year before the enactment of the Revenue Act of 1942 all income in respect of such decedent was includible in his gross income for such taxable year, unless properly includible in gross income for a prior taxable year. See § 29.42–1. Section 134 (g) of the Revenue Act of 1942 gives the estate of the decedent and those persons entitled upon his death to receive amounts of income not includible in the income of the decedent under his method of accounting (but includible in his income under the provisions of section 42) the right to elect to have such amounts treated for tax purposes under the amendments made by the Revenue Act of 1942, that is, to exclude from the gross income of the decedent for his last taxable year any such amounts not includible therein under his method of accounting, and to include such amounts when received in the gross income of the estate and of the other persons entitled to such amounts by bequest, devise, and inheritance and by reason of the death of the decedent. The election to have these amounts treated in this manner is made by the filing of consents to such treatment by the fiduciary of the estate

and by all such persons. Section 134 (g) of the Revenue Act of 1942 provides in part as follows:

(g) *Taxable years before 1943.* In case the taxable period in which falls the date of the death of the decedent began after December 31, 1933, and before January 1, 1943, the tax for such taxable period shall be computed as if provisions corresponding to the provisions of sections 42 (a) and 43 of the Internal Revenue Code, as amended by subsections (a) and (b) of this section, were a part of the Revenue Act of 1934, the Revenue Act of 1936, the Revenue Act of 1938, or the Internal Revenue Code, whichever is applicable to such taxable period. In the case of the estate of such a decedent and of each person who acquires by reason of the death of such decedent or by bequest, devise, or inheritance from such decedent the right to receive the amount of items of gross income of the decedent which upon the application of the preceding sentence are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period, the tax for each taxable period ending on or after the date on which the decedent died shall be computed by including in gross income the amounts with respect to such decedent which would be includible, and by allowing as deductions and credits the amounts with respect to such decedent which would be allowable, if provisions corresponding to the provisions of the section inserted in the Internal Revenue Code [section 126] by subsection (e) of this section were a part of the law applicable to such taxable period. The provisions of this subsection shall not be applicable unless there are filed with the Commissioner (in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, and at the time prescribed by such regulations) signed consents made under oath by the fiduciary representing the estate and by each such person (or if any such person is no longer in existence or is under disability, by his legal representative) that with respect to such amounts the tax of the estate, or the tax of such person, as the case may be, shall be computed under the provisions of this subsection for each taxable period ending on or after the date of the death of the decedent and the tax of the decedent shall be computed under such provisions for the taxable period of the decedent in which falls the date of his death. If such consent is filed after the time for the filing of the return with respect to any such taxable period, the deficiency resulting from the failure to compute the tax for such taxable period in accordance with such consent shall be paid on the date of the filing of the consent with the Commissioner, or on the date prescribed for the payment of the tax for the taxable period, whichever is later, and the period of limitations provided in sections 275 and 276 of the Internal Revenue Code * * * on the making of assessments and the beginning of distraint or a proceeding in court for collection shall with respect to such deficiency include one year immediately after the date the consent was filed, and such assessment and collection may be made notwithstanding any provision of the internal revenue laws or any rule of law which would otherwise prevent such assessment and collection. The period within which claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, with respect to any overpayment resulting from the failure to compute the tax for any such taxable period (except the taxable period of the decedent in which falls the date of his death) in accordance with such consent shall include one year immediately after the date of the filing of the consent, and credit or refund may be allowed or made notwithstanding any provision of the internal revenue laws or any rule of law which would otherwise prevent such credit or refund, but no interest shall be allowed or paid with respect to any such overpayment. The provisions of section 322 (b) (2) and (3) of the Internal Revenue Code * * * shall not apply to the refund of any such overpayment. If the application of this subsection to the taxable period of the decedent in which falls the date of his death results in a deficiency for such taxable period, and if the income tax of the decedent for such period was deducted in computing the net estate of the decedent under Chapter 3 of the Internal Revenue Code * * * and if at the time such deficiency is assessed credit or refund of any resulting overpayment in respect of the taxes imposed by such Chapter 3 * * * upon such net estate is prevented by any provision of the internal revenue laws or by any rule of law, then the amount of such deficiency which is assessed and collected shall be reduced by the amount of such resulting overpayment under such Chapter 3 * * * which would be credited or refunded if credit or refund thereof were not so prevented. This subsection shall not be deemed to change any provision of law limiting the allowance of refund or credit with respect to overpayments for the taxable period of the decedent in which falls the date of his death, and no interest shall be allowed or paid with respect to any overpayment resulting from the application of this subsection to such taxable period. If the application of this subsection to the taxable period of the decedent in which falls the date of his death results in an overpayment for such taxable period, and if such overpayment was included as part of the income tax of the decedent which was deducted in computing the net estate of the decedent under Chapter 3 of the Internal Revenue Code * * * and if, at the time such overpayment is credited or refunded the assessment and collection of deficiencies in respect of the taxes imposed by such Chapter 3 * * * upon such net estate is prevented by any provision of the internal revenue laws or by any rule of law, then the amount of such overpayment which is credited or refunded shall be reduced by the amount of the resulting deficiencies under such Chapter 3 * * * which would be assessable if the assessment and collection thereof were not so prevented.

(b) *Consents; tax of estate and persons filing consents.* For the purposes of the election provided by section 134 (g) of the Revenue Act of 1942, the consents must be filed by the fiduciary of the estate and by each person who received any right to income in respect of the decedent by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent. Ordinarily, the persons who must file such consents are the administrator or the executor of the estate, the residuary beneficiary of the estate, the trustees and beneficiaries of any trust the corpus of which includes such right to income, every other specific beneficiary or such right, and every person who receives any such right by survivorship, such as the surviving joint tenants of any right to income held in joint tenancy and the surviving coowners or beneficiaries of any defense bonds owned by the decedent on which there is accrued interest not includible in his gross income under his method of accounting. If any such person is not in existence or is under legal disability, the consent may be made by his legal representative.

All of such consents with respect to any one decedent shall be filed at the same time with the Commissioner of Internal Revenue, Washington, D. C. The consents must be filed not later than one year after the time prescribed for filing the return for the last taxable year of the decedent (not including any extension of time for such filing) or January 1, 1944, whichever is later.

The executor, administrator, or other fiduciary of the estate (or if there is no such fiduciary, the principal beneficiary of the estate) must submit, under oath, a statement accompanying the consents and containing the following information:

(1) A list of all the items included in the gross income of the decedent for his last taxable year which would not be includible therein if the amendments made by section 134 (a) of the Revenue Act of 1942 were applicable to the revenue law in effect for such taxable year. See § 29.42–1.

(2) The amount included in gross income with respect to each of such items, the aggregate of such amounts, the value included in the gross estate of the decedent with respect to each such item for the purposes of the estate tax, and the aggregate of such values.

(3) A list of all the items, allowed as deductions and credits in computing the net income of the decedent for his last taxable year, which would not be allowable as deductions and credits if the amendments made by section 134 (b) of the Revenue Act of 1942 were applicable to the revenue law in effect for such taxable year. See § 29.43–1.

(4) The amount allowable as a deduction or credit with respect to each such item listed in (3), the aggregate of such amounts, the amount of the deductions for estate tax purposes from the gross estate of the decedent in respect of claims which are founded upon that portion of such items as are described in section 126 (b), and the aggregate of such deductions.

(5) The names and addresses of every person entitled by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent to receive any amount listed in (1).

(6) The names and addresses of every person entitled by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent to receive any property subject to an obligation of the decedent for which a deduction or credit described in § 29.126–2 is allowable.

Each consent shall be made under oath and shall contain the following:

(i) The name and address of the person filing the consent, and the collection district in which he files his return.

(ii) The name and address of the decedent, the date of his death, the period covered by his last income tax return, and the collection district in which such return was filed.

(iii) A list of all the items (at face value) of income in respect of the decedent to which the person filing the consent was entitled by request, devise, or inheritance from the decedent or by reason of the death of the decedent. If the person filing the consent is the fidu-

ciary of the estate of the decedent, the list shall set forth every item (at face value) of income in respect of the decedent acquired by the estate from the decedent. If any items listed on the consent were collected before the time the consent was filed, or if the right to receive any such items was transferred before such time to any person not entitled to such right by bequest, devise, or inheritance, or by reason of the death of the decedent, then the list must show the amount collected in respect of each such item, or its fair market value at the time it was transferred, any consideration received for the transfer, and the date of such collection or transfer.

(iv) A list of all the items in respect of the decedent for which such person may claim deductions and credits described in § 29.126–2, showing the face value of such items, the property received by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent subject to the obligation for which any such deduction is allowed, and, if any such obligation has been paid, the amount and date paid.

(v) A recomputation of the net income and of the tax of the person filing the consent, made (*a*) for each taxable year in which any item described in (ii) was collected, or in which the right to any such item was transferred to a person not entitled to such right by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent, (*b*) for each taxable year in which any item listed in (iv) was paid, or would otherwise be allowed as a deduction or credit under § 29.126–2, and (c) for each taxable year in which there is a carry-over or carry-back of any item from any taxable year described in (*a*) and (*b*). Such recomputation shall be made under the provisions of §§ 29.126–1, 29.126–2, and 29.126–3 by including in gross income the income in respect of the decedent which is includible under section 126 (a) and by allowing as deductions and credits the deductions and credits which are allowable under section 126 (b) and (c) when section 126 is made applicable to such taxable year and when the amendments made by section 134 (a) and (b) of the Revenue Act of 1942 are made applicable to the law in effect for the last taxable year of the decedent (see §§ 29.42–1 and 29.43–1). This recomputation shall be made only for taxable years the returns for which were due prior to the date the consent is filed. The increase or decrease in tax for each such taxable year as a result of such recomputation shall be shown, as well as the aggregate of such increases and the aggregate of such decreases.

(vi) An unqualified statement by the person filing the consent agreeing that his tax for each taxable year ending on or after the date the decedent died and the tax of the decedent for his last taxable year shall be computed under the provisions of section 134 (g) of the Revenue Act of 1942.

A payment equal to the excess of the aggregate of the increases over the aggregate of the decreases in tax set out in (e) on the consent must accompany the filing of the consent. The period of limitations for assessing or collecting the increase in tax upon such recomputation for each such previous year includes one year immediately after the filing of the consents, and such assessment and collection may be made whether or not any period of limitation or any rule of law (such as a previous judicial determination of the tax liability for such year) would otherwise prevent such collection or assessment. Interest on the increase in tax for each previous taxable year is measured from the date prescribed by law for the payment of the tax for such previous taxable year. If the aggregate of the decreases in tax exceeds the aggregate of the increases in tax, the taxpayer may file claim for credit or refund of such excess, and the period of limitation for filing such claim includes one year immediately after the filing of the consents. Such credit or refund may be made whether or not any period of limitations or any rule of law would otherwise prevent such credit or refund. The amount of such credit or refund will not be limited by section 322 (b) (2) or (3). No interest will be allowed with respect to any such credit or refund.

The person filing his consent must compute his tax for each taxable year, the return for which is due on or after the date the consent is filed, under the provisions of section 126 as if the amendments made by section 134 (a) and (b) were effective with respect to the revenue law applicable to the taxable year in which the decedent died. See §§ 29.42–1, 29.43–1, 29.126–1, 29.126–2, and 29.126–3. See also §§ 19.42–1 and 19.43–1 of this chapter, and paragraph 8 of Treasury Decision 5233, approved February 26, 1943.[1]

(c) *Tax for last taxable year of decedent if consents filed.* If the consents described in paragraph (b) of this section are properly filed, the tax of the decedent for his last taxable year is computed as if the amendments made by section 134 (a) and (b) of the Revenue Act of 1942 were applicable to the revenue law in effect for such taxable year of the decedent. See §§ 29.42–1 and 29.43–1. However, no interest shall be allowed with respect to any credit or refund of any overpayment for such taxable year resulting from the application of these amendments. Furthermore, credit or refund of any such overpayment is only allowed subject to the provisions of section 322, and nothing in section 134 of the Revenue Act of 1942 makes any change in any provision of law which limits the allowance of credit or refund of an overpayment for the last taxable year of the decedent. Thus, if the claim for the credit or refund of an overpayment, caused by the application of section 134 (g) of the Revenue Act of 1942, is not filed within three years after the return for the last taxable year of the decedent was filed or two years after the last payment of tax for such taxable year was made, then no refund is allowable. If the claim is filed within such period, the refund which may be made must not exceed the portion of the tax paid within the period, preceding the filing of the claim for credit or refund, prescribed by section 322 (b) (2).

In cases in which the decedent had more deductions subject to the amendment made by section 134 (b) of the Revenue Act of 1942 than income subject to the amendment made by section 134 (a) of such Revenue Act, a deficiency for his last taxable year may result from the retroactive application of such amendments under section 134 (g) of that Act. Since the estate and the beneficiaries, in the filed consents, agree to the redetermination of the tax of the decedent for his last taxable year, such tax will be assessed and collected notwithstanding the prior running of any period of limitations or any other rule of law which would otherwise bar such assessment and collection.

Since the income tax of the decedent for his last taxable year was deductible as a claim against his estate in determining the estate tax, any overpayment of income tax for his last taxable year may have been an improper deduction from his gross estate. Therefore, if any such overpayment is determined for such taxable year by reason of the application of section 134 of the Revenue Act of 1942, the estate tax must then be recomputed by disallowing any deduction of such overpayment of income tax, and upon this recomputation a deficiency in estate taxes may be determined. If at the time any credit or refund of such overpayment in income tax is allowed or made, the assessment and collection of the deficiency in estate taxes are barred by any provision of the internal revenue laws or by any rule of law, then the amount of such deficiency in estate taxes is deducted from the amount which would otherwise be refunded or credited.

Similarly, if there was a deficiency in income tax for the last taxable year of the decedent, by reason of the application of section 134 (g) of the Revenue Act of 1942, then the deduction for income tax of the decedent in computing his net estate for estate tax purposes may have been too small, and an overpayment of estate taxes may have resulted. If credit or refund of this overpayment is barred at the time the deficiency in income taxes is assessed, the amount of the deficiency in income taxes shall be reduced by the amount of any such overpayment in estate taxes.

SEC. 127. WAR LOSSES [as added by sec. 156 (a), Rev. Act 1942].

(a) *Cases in which loss deemed sustained, and time deemed sustained.* For the purposes of this chapter—

(1) *Property not in enemy countries.* Property destroyed or seized on or after December 7, 1941, in the course of military or naval operations by the United States or any other country engaged in the present war shall be deemed to have been destroyed or seized on a date chosen by the taxpayer in the manner provided in paragraph (4), which falls between—

(A) the latest date, as established to the satisfaction of the Commissioner, on which such property may be considered as not destroyed or seized, and

(B) the earliest date, as established to the satisfaction of the Commissioner, on which such property may be considered as having already been destroyed or seized.

[1] 8 F.R. 2554.

For the purposes of this paragraph property within an area which comes under the control of a country at war with the United States after the date war with such country is declared by the United States shall be deemed to have been destroyed or seized in the course of military or naval operations by such country, and the date specified in subparagraph (A) shall not be later than the latest date determined by the Commissioner as the date on which such area was under the control of the United States or a country not at war with the United States, and the date specified in subparagraph (B) shall not be later than the earliest date determined by the Commissioner as the date on which such area may be considered under the control of the country which is at war with the United States.

(2) *Property in enemy countries.* Property within any country at war with the United States, or within an area under the control of any such country on the date war with such country was declared by the United States, shall be deemed to have been destroyed or seized on the date war with such country was declared by the United States.

(3) *Investments referable to destroyed or seized property.* Any interest in, or with respect to, property described in paragraph (1) or (2) (including any interest represented by a security as defined in section 23 (g) (3) or section 23 (k) (3) which becomes worthless shall be considered to have been destroyed or seized (and the loss therefrom shall be considered a loss from the destruction or seizure) on the date chosen by the taxpayer which falls between the dates specified in paragraph (1), or on the date prescribed in paragraph (2), as the case may be, when the last property (described in the applicable paragraph) to which the interest relates would be deemed destroyed or seized under the applicable paragraph. This paragraph shall apply only if the interest would have become worthless if the property had been destroyed. For the purposes of this paragraph, an interest shall be deemed to have become worthless notwithstanding the fact that such interest has a value if such value is attributable solely to the possibility of recovery of the property, compensation (other than insurance or similar indemnity) on account of its destruction or seizure, or both. Section 23 (g) (2) and (k) (2) shall not apply to any interest which under this paragraph is considered to have been destroyed or seized. Under regulations prescribed by the Commissioner with the approval of the Secretary, a taxpayer which owns 100 per centum (excluding qualifying shares) of each class of stock of a corporation may elect to determine the worthlessness of its interest, described in this paragraph, in or with respect to the property of the corporation, without regard to the amount of the property of such corporation which would be excluded under subsection (e) (2) (A) in determining the adjusted basis of all the assets of the corporation for the purposes of subsection (e), but such amount shall be treated under subsection (b) (1) as a recovery by the taxpayer in the taxable year with respect to such interest.

(4) *Choice of date.* The taxpayer's choice of a date under paragraph (1) or (3) shall be effective only if made within such time and in such manner as may be prescribed by regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.127 (a)–1 *Description of war losses.* Under section 127, property destroyed or seized in the course of the present war and property which is within an enemy country or an enemy controlled area on the date the United States declares that a state of war exists with the enemy country result in war losses. Property which is within an area that comes under the control of an enemy country after the date the United States declares that a state of war exists with such enemy country also results in a war loss. An investment in any of the foregoing property which loses all its value because of the war loss resulting from such property is itself treated as resulting in a war loss. Investments in such property which lose only part of their value by reason of such property resulting in a war loss are also treated, under certain circumstances, as resulting in a war loss to the extent of such loss in value. See section 127 (e).

Section 127 (a) and (e) provides that the property and investments described above shall be treated as being "destroyed or seized" upon the date specified in the applicable subsections. That is, upon such date the taxpayer is treated as losing his entire interest in such property or investment, and this loss of such property rights is deemed to be sustained by reason of a casualty. The casualty is the destruction or seizure, whichever event the taxpayer claims occurred. If the property or investment was held for more than six months and was a capital asset or property used in the trade or business of the taxpayer, this loss (and any compensation therefor) is subject to the provisions of section 117 (j), relating to gains and losses upon involuntary conversions. See § 29.117–7. Unless such loss is treated under section 117 (j) as a loss from the sale or exchange of a capital asset, such loss is deductible as an ordinary loss under the provisions of section 23 (f) in the case of a corporation and section 23 (e) (3) in the case of an individual. The loss upon an investment which is treated under section 127 as resulting in a war loss is not subject to the provisions of section 23 (g) (2) and (k) (2) which treat losses upon worthless securities as capital losses, although such loss may nevertheless be treated under section 117 (j) as a loss upon the sale or exchange of a capital asset.

For property to be treated as resulting in a war loss, such property must be in existence on the date prescribed in section 127 (a) (2) as the date it is deemed destroyed or seized or at the beginning of the period prescribed in section 127 (a) (1) or (a) (3), within which period the property is deemed destroyed or seized, and for the taxpayer to claim a loss with respect to such property he must own such property or an interest therein at such time. If, before such time, the property was destroyed or confiscated, section 127 is not applicable with respect to such property. For example, a taxpayer owned property in an enemy country before war was declared on such enemy by the United States, and such property was confiscated by the enemy before the date war was declared. The seizure was not in the course of military or naval activities. The taxpayer may not claim a war loss with respect to such property under section 127.

For the purposes of section 127, the term "area" does not mean a territory or political unit but means the locality in which the property was situated.

The date on which a war loss was sustained must be determined under the provisions of section 127 (a) and the regulations thereunder. The amount of loss sustained must be determined subject to the provisions of section 127 (b) and the regulations thereunder. Income to the taxpayer upon any recovery of or in respect of property or investments treated as resulting in a war loss must be determined under section 127 (c) and the regulations thereunder. The basis of any such recovery must be determined under section 127 (d) and the regulations thereunder.

§ 29.127 (a)–2 *Property destroyed or seized after the outbreak of war.* Section 127 (a) (1) has two main purposes. One is to provide that property shall be treated as destroyed or seized if it is located in an area which comes under the control of an enemy country after the date the United States declares that a state of war exists with such enemy country. This provision corresponds to the provisions of section 127 (a) (2) which give similar treatment to property located in an area under enemy control on the date the United States declares that a state of war exists with the enemy. See § 29.127 (a)–3. The other purpose of section 127 (a) (1) is to provide the method for determining the date on which such destruction or seizure is deemed to occur in cases in which the exact date when control is established cannot be determined, and to provide the method for determining the date of destruction or seizure in the case of property actually destroyed or seized in the course of military or naval operations by any country engaged in the present war if the exact date of such destruction or seizure cannot be established.

(a) *Actual destruction or seizure.* Any property actually destroyed or seized in the course of military or naval operations by the United States or any other country engaged in the present war shall be deemed to have been destroyed or seized on any date chosen by the taxpayer which falls between:

(1) The latest date, as established to the satisfaction of the Commissioner, on which such property may be considered as not destroyed or seized, and

(2) The earliest date, as established to the satisfaction of the Commissioner, on which such property may be considered as having already been destroyed or seized.

If the exact date of the destruction or seizure can be ascertained, then (1) refers to the day before such date and (2) refers to the day after such date. Thus, if the taxpayer knows that his property was destroyed during a bombing raid on London on January 7, 1942, the latest date on which such property may be considered as not destroyed is January 6, 1942, and the earliest date on which it may be considered as being already destroyed is January 8, 1942. Under section 127 (a) (1), the only date the taxpayer may choose is January 7, 1942. However, in many cases the taxpayer will not be able to ascertain the exact date on which the destruction or seizure of his property occurred. In such cases the taxpayer may claim that the destruction or seizure occurred at any time he

chooses between the dates prescribed in (1) and (2) of this paragraph, which dates may be established on the basis of such information as the taxpayer is reasonably able to obtain. For example, the taxpayer's property was destroyed during a bombardment of a certain area which lasted several days. The taxpayer is only able to ascertain that the property was undestroyed before the bombardment, and was already destroyed when the bombardment ended. The taxpayer may treat the destruction as occurring on any date during the bombardment.

Section 127 (a) (1) refers to a destruction or seizure by the United States or any other country engaged in the present war. Such other countries are the members of the United Nations, any other countries at war with enemies of the United States, and the enemies of the United States or of any of the United Nations. Thus, a country which is not a member of the United Nations nor an enemy of the United States is nevertheless considered engaged in the present war if it is an enemy of any other member of the United Nations. Furthermore, the military or naval operations need not be carried on by the regular forces of the countries engaged in the present war, but it is sufficient if such operations are carried on by any forces supported by or operating in conjunction with any such country. For example, nationals of the D country form an independent fighting force for the liberation of their country, which was conquered by an enemy of the United States, and such fighting force operates in conjunction with the forces of one or more of the United Nations. The military or naval operations of such force are considered for the purposes of section 127 (a) (1) as military or naval operations by the countries, engaged in the present war, with which such forces operate.

The term "military or naval operations" in section 127 (a) (1) is used in a broad sense to cover all actions incident to belligerent activities, whether in furtherance of or in opposition to such activities. It includes operations carrying out a scorched earth policy or rendering a position under threat of attack or other danger more secure or less desirable to the attacker. For example, when invasion of a certain area by the forces of an enemy is imminent, civilians in such area burn and otherwise destroy warehouses and other property in such area. Such property is destroyed in the course of military or naval operations of the enemy. However, the orderly requisition or condemnation of property by any government, in the ordinary course of which the taxpayer is entitled to fair compensation, is not a destruction or seizure in the course of military or naval operations.

(b) *Property deemed destroyed or seized by reason of enemy control.* Property in an area which, after the date the United States declares war with a country, comes under the control of such enemy country is deemed to have been seized or destroyed in the course of military or naval operations by such country. Such destruction or seizure is deemed to occur on any date chosen by the taxpayer which falls between the latest date, as determined by the Commissioner, on which the area was under the control of the United States or a country not at war with the United States, and the earliest date, as determined by the Commissioner, on which the area was under the control of the enemy country.

If during the period described in the above paragraph the property in such area was actually destroyed or seized in the course of military or naval operations by any country engaged in the present war, the taxpayer may choose as the date on which the destruction or seizure occurred any date falling after whichever of the following dates is the earlier:

(1) The latest date, as established to the satisfaction of the Commissioner, on which such property may be considered as not destroyed or seized, or

(2) The latest date determined by the Commissioner as the date on which such area was under the control of the United States or a country not at war with the United States,

and falling before whichever of the following dates is the earlier:

(i) The earliest date, as established to the satisfaction of the Commissioner, on which such property may be considered as having already been destroyed or seized, or

(ii) The earliest date determined by the Commissioner as the date on which such area may be considered under the control of the country which is at war with the United States.

For example, the taxpayer has property in an area under the control of a country not at war with the United States. Such country lost control of the area on December 20, 1942, under attack by the enemy, but the taxpayer who remained in the area ascertains that the property was not destroyed on that date, but was destroyed during further fighting on January 1, 1943. An enemy country gained control of the area on February 1, 1943. The earliest date on which the taxpayer may claim the loss is December 20, 1942, the day after the latest date on which the area was under control of a country not at war with the United States. The latest date on which it may claim the loss is January 1, 1943, the day before the earliest date on which the property may be considered as having already been destroyed. An additional example is the case of a taxpayer with property in an area evacuated on December 15, 1942, when a country not at war with the United States lost control of such area. The property of the taxpayer in such area was undestroyed on such date. An enemy country established control over the area on January 21, 1943. The taxpayer learns that on July 15, 1943, the property was destroyed in a bombing raid on such area. The loss may not be claimed as occurring on any date later than January 20, 1943, the day before the earliest date on which the enemy country was in control of the area.

Whether or not a country at war with the United States gains control over intangible property by reason of its gaining control over any area is determined under the same provisions as are applicable for the purposes of section 127 (a) (2) in determining whether intangible property is subject to the control of the enemy country on the date war is declared. See § 29.127 (a)-3.

In the case of any property which is within the provisions of section 127 (a) (1) by reason of any area falling under the control of an enemy of the United States, it is necessary to determine the latest date on which the United States or any country not at war with the United States was in control of such area and the earliest date on which the country at war with the United States was in control of such area. For the purposes of section 127 (a) (1), control of an area on any day means effective control which is not seriously disputed at any time during such day. For such control to exist, order must be maintained in the area, such order must be maintained by authority of the country in control, and such order must not be seriously disputed by hostile action either by elements of the civilian population or by the armed forces of any other country. Section 127 (a) (1) contemplates that in many cases there will be a lapse of time between the date when one country loses control of an area and the date when another country gains control. During this period neither country will be in control of the area, and the loss may be claimed to occur at any time during such period. The fact that any country loses control of an area is not sufficient for the purposes of section 127 (a) (1) unless a country at war with the United States gains control of such area. That is, if a country not at war with the United States, which has lost control of an area, regains control of the area before a country at war with the United States gains control, the fact that control was lost for a period of time does not cause any property in the area to be deemed to have been destroyed or seized.

It should be noted that the term "area" means the locality in which the property is situated. The determination as to whether control by any country was lost or established in any area on any date will be made in a practical manner on the basis of all factors, and particular attention will be paid to the nature of the military and political operations affecting the control over such area as well as to the amount of information which can be obtained under the circumstances. For example, in view of the fact that the island of Luzon was one theater of military operations, complete control over such island by the American and Philippine forces will be considered to have ceased in December 1941, upon the beginning of the Japanese invasion of the island, and complete Japanese control will be considered to have begun in May 1942, upon the cessation of American resistance at Corregidor. In the absence of information to the contrary, control by American and Philippine forces over other Philippine islands will be considered to have ceased on the date in December 1941 when complete control of

Luzon ceased, and Japanese control over such other islands will be considered to have begun on the date in May 1942 when complete Japanese control of Luzon began. Similarly, control over areas in other theaters of military or political action will be determined on the basis of the principal events in such theaters of action.

A country at war with the United States may gain control over an area by its armed forces, by its civil authorities, or by obtaining control over the local authorities already established in that area. Such control over local authorities will not be deemed to exist by reason of the enemy country's domination over the government of any country if and so long as the United States maintains diplomatic relations with such government. Areas formerly subject to such government but actually taken over by armed forces or civil authorities of the enemy country are under the control of the enemy country. If the United States has not declared that a state of war exists with any country, the control by such country over any area is not deemed a destruction or seizure of property in such area, even though such country may be considered engaged in the present war by reason of its being an enemy of one of the United Nations.

The latest date on which the United States or a country not at war with the United States was in control of an area, and the earliest date when an enemy of the United States was in control of an area, are questions of fact to be determined by the Commissioner on the basis of the facts established by the taxpayer and such other information as may be in his possession. The Commissioner may from time to time issue rulings on the basis of all information then in his possession as to such dates as he has already determined with respect to any areas. Such rulings will be subject to change in the event further information is obtained. In the absence of any applicable ruling, the facts established by the taxpayer must satisfy the Commissioner that the dates chosen are proper.

(c) *Choice of date when loss deemed sustained.* Section 127 (a) (1) grants the taxpayer the right to choose within the period described in paragraphs (a) and (b) of this section the date on which the destruction or seizure of property is deemed to occur. This choice of a date is exercised by claiming a gain or loss with respect to such destruction or seizure in a return for a taxable year in which such date falls, in a claim for credit or refund of an overpayment for such taxable year, or in a petition to The Tax Court of the United States with respect to such taxable year. Until the taxpayer makes such a choice upon a return, a claim, or a petition, he will be deemed to have chosen the latest date on which the destruction or seizure may be treated as having occurred. Such latest date will be considered for all purposes the date chosen by the taxpayer if the taxpayer has not chosen on a return, claim, or petition, in the manner described above, any other date by the time the return for the period in which such latest date falls is due (including any extension of time for filing such return). Thereafter, the taxpayer may choose another date only with the permission of the Commissioner. If the taxpayer has once made the choice described above by the filing of a return, a claim, or a petition in which gain or loss is claimed with respect to the destruction or seizure, such choice (whether made before or after the enactment of the Revenue Act of 1942) may not thereafter be changed except with the permission of the Commissioner.

A taxpayer desiring to make a new choice of date with the permission of the Commissioner shall send a copy of his return, claim for refund, or petition in which he makes such new choice to the Commissioner of Internal Revenue, Washington, D. C., together with a statement of the date previously used as the date of the destruction or seizure, the new date chosen, and a recomputation of each tax imposed by the Internal Revenue Code (including income, excess profits, and declared value excess profits taxes) for each taxable year affected by such change of date. For example, if the taxpayer on the calendar year basis desires to change his choice of date from a date in 1942 to one in 1943, and if there was a carry-back of unused excess profits credit from 1942 to 1941, the taxpayer must attach to his request for permission to change his choice of date a recomputation of the tax for 1943, reflecting the tax effect of treating the destruction or seizure as occurring in that year, for 1942, reflecting the effect of treating the destruction or seizure as not occurring in such year, and for 1941, computed with the carry-back from 1942 determined by treating the destruction or seizure as occurring in 1943 and not 1942.

The taxpayer must also attach to his request a statement as to whether the tax for any taxable year affected by the change of date has been determined by The Tax Court of the United States or by any court, whether a case with respect to any such tax liability is pending in any such tribunal, and whether any period of limitations or rule of law would prevent the proper adjustment of the tax liability for each such year if the change in date were permitted. The Commissioner will permit the taxpayer to change his choice of the date of the destruction or seizure if such proper adjustments may be made for each taxable year affected.

§ 29.127 (a)–3 *Property in enemy countries and enemy controlled areas.* Property in a country at war with the United States, or in an area controlled by such country, on the date the United States declared that a state of war existed with such country is deemed under section 127 (a) (2) to have been destroyed or seized on such date.

The term "property" includes tangible property of every kind actually within such country or area. Whether or not intangible property is within the provisions of section 127 (a) (2) depends in general upon whether the enemy country exercises the same control over such intangible property as it exercises over tangible property located within such country or area. If the enemy country may legally divest the taxpayer of his right to such intangible property in such manner that all other jurisdictions having control of any of the obligations and assets from which such intangible property derives its value would not recognize the taxpayer as having any interest in such obligations and assets, then such intangible property is within the provisions of section 127 (a) (2). For example, a taxpayer owns stock and bonds in a corporation chartered by an enemy country. All of the assets of such corporation are in the enemy country, in a neutral country, and in a country also at war with the enemy country. The enemy country may sequester the taxpayer's interest in such stock and bonds. The neutral country recognizes the control of the enemy country over its corporation, and would not grant the taxpayer any right of recourse against the assets of the corporation located in such country. The country at war with the enemy country treats the assets of the corporation located within its jurisdiction as enemy property and would grant the taxpayer no rights in such assets during the war. The stock and bonds of the taxpayer are property within the enemy country and subject to the provisions of section 127 (a) (2). A further example is the case of a taxpayer having negotiable bonds in a corporation chartered in a neutral country. Such bonds are in the enemy country at the outbreak of the war, in the hands of an agent of the taxpayer. The neutral country does not recognize the authority of the enemy country to divest the taxpayer of his right to these bonds. Such bonds are not property subject to the provisions of section 127 (a) (2).

Ordinarily, if the right of the taxpayer to the intangible property exists by reason of the law and authority of the enemy country, section 127 (a) (2) applies to such intangible property. For example, all public bonds of a country at war with the United States are considered to be within the provisions of section 127 (a) (2). On the other hand, the public bonds of a country not at war with the United States, the territory of which is occupied by a country at war with the United States on the date war is declared, are not within the provisions of section 127 (a) (2). Any interest in a corporation chartered by a country at war with the United States will be considered intangible property located in the enemy country unless the taxpayer has any rights to assets of such corporation not treated as destroyed or seized under section 127. However, any interest in a corporation chartered by a country not at war with the United States, the territory of which is occupied by a country at war with the United States, will not be considered intangible property located in an area under the control of an enemy country. Any intangible property not within the provisions of section 127 (a) (2) may be within the provisions of section 127 (a) (3), which relate to intangible property which becomes worthless by reason of war losses. See § 29.127 (a)–4.

For the purposes of section 127 (a) (2), the control by the enemy country

over any area may be exercised either through its military or civil agencies, or through its control over the local authorities. Thus, an area will be treated as being under the control of the enemy country if the enemy country exercises its control through the agents of a puppet government or through the local governmental organization in operation at the time it gained control of the area. Such control over local authorities will not be deemed to exist by reason of the enemy country's domination over the government of any country if the United States maintains diplomatic relations with such government. Areas formerly subject to such government but actually taken over by armed forces or civil authorities of the enemy country are under the control of the enemy country. Areas under the control of the governments of Hungary, Rumania, and Bulgaria will not be considered under enemy control prior to the date the United States declared that a state of war existed with such governments. Whether or not control by the enemy country exists is a question of fact which the Commissioner will determine on the basis of the facts established by the taxpayer and such other facts as may be in his possession.

§ 29.127 (a)–4 *Investments referable to destroyed or seized property.* Section 127 (a) (3) provides that intangible property which is an interest in or with respect to underlying assets treated as destroyed or seized under section 127 (a) (1) and (2) shall itself be treated as being destroyed or seized if it would be worthless if such underlying assets had in fact been destroyed. The intangible property may be of any kind, provided it meets the test that it would become worthless upon the actual destruction of the underlying assets treated as destroyed or seized under section 127 (a) (1) and (2). Thus, it may be represented by accounts receivable from or by stocks, bonds, or other securities in a corporation all of the assets of which are treated as destroyed or seized under section 127 (a) (1) or (2), or by obligations of an individual, under the control of an enemy country, all of whose assets are also under the control of the enemy country. Any intangible property which derives its value from underlying assets treated as destroyed or seized under section 127 (a) (1) and (2) is considered an interest in or with respect to such assets for the purposes of section 127 (a) (3). For example, if all of the assets owned by a holding company are securities within the provisions of section 127 (a) (3) as being issued by corporations owning only property described in section 127 (a) (1) and (2), then stock in such holding company is considered an interest in or with respect to such property described in section 127 (a) (1) and (2), and is subject to the provisions of section 127 (a) (3).

For intangible property to be treated as destroyed or seized under section 127 (a) (3) the following tests must be met:

(a) Such property must be worthless if the value described in the next paragraph is disregarded; and

(b) Such property must be of a kind which would have become worthless upon the destruction of all the underlying assets which are described in section 127 (a) (1) and (2). That is, upon the date the last underlying asset described in section 127 (a) (1) or (2) is deemed destroyed or seized, there must be no other underlying asset from which such property derives a value. In applying this test as to whether the intangible property would have become worthless if the underlying assets treated as destroyed or seized under section 127 (a) (1) and (2) were actually destroyed, all interest in such assets shall be considered to have ceased as if such assets had been totally destroyed, whether or not any such asset, such as land, may ordinarily be considered indestructible. Furthermore, the value described in the next paragraph is disregarded in determining whether such property would have become worthless.

In determining for the purposes of both (a) and (b) whether property has become worthless, any value attributable to the possibility of recovering assets treated as destroyed or seized under section 127 (a) (1) and (2) or of compensation (other than insurance or similar indemnity) for their destruction or seizure, such as an award by a government upon the completion of the war, shall be disregarded. Insurance or any other certain indemnity by a government is not disregarded. For the purposes of (a) any value attributable to an actual recovery in the taxable year in which the loss is claimed or, if the possibility of receiving compensation develops during such taxable year into a recognized right to compensation, attributable to such right to compensation, will prevent the intangible property from becoming worthless, and will therefore keep such property from being treated as a war loss under section 127 (a) (3).

Whether or not intangible property is worthless when the underlying assets described in section 127 (a) (1) and (2) are treated as destroyed or seized is a question of fact to be established by the taxpayer. Thus, the intangible property may be worthless even though there are underlying assets which are not treated as destroyed or seized under section 127 (a) (1) and (2) if it derives no value from such other assets, as in a case in which there are obligations actually enforceable against such assets which are superior to the interest in such assets represented by the intangible property. For example, a corporation has $100,000 of assets, $80,000 of which are treated as destroyed or seized under section 127 (a) (1) and (2), and $20,000 of which are located in the United States and are not within the provisions of section 127 (a) (1) and (2). The corporation owes considerably more than $20,000 to creditors in the United States. Any stock interest in such corporation is considered worthless. If the corporation owed only $10,000 to creditors who could enforce their claims against the corporation, and owed $40,000 to creditors who are alien enemies of the United States, located in countries at war with the United States, who could not enforce their claims against the corporation, the stock is not considered worthless. The fact that any underlying assets, not under the control of a country at war with the United States, are subject to stringent controls by the United States or by any other government, such as being placed in blocked accounts or under "freezing" controls, or otherwise under the custody of the government, will not cause any interest in such assets to be considered worthless. Such assets are merely subject to government regulation, and the interest in or with respect to such assets continues subject to such regulation.

The intangible property interest described in section 127 (a) (3) is deemed to be destroyed or seized upon the date that the last of the underlying assets subject to the provisions of section 127 (a) (1) or (2) was treated as destroyed or seized under that section. In determining for such purposes when any property described in section 127 (a) (1) was destroyed or seized, the taxpayer may choose any date described in that section which he could properly choose under that section if he were the owner of such property. The choice is made by the taxpayer's claiming a loss with respect to the destruction or seizure of the intangible property described in section 127 (a) (3) in a return for the taxable year in which the date chosen falls, or in a claim for credit or refund of an overpayment for such taxable year, or in a petition to The Tax Court of the United States with respect to such taxable year. If no such choice is made, the date chosen will be deemed to be the latest date which could be chosen under section 127 (a) (1). If at the time the return for the taxable year in which such latest date falls is due (including any extension of time for filing such return), the taxpayer has not so chosen a date in a return, claim for refund, or petition, such latest date will be considered for all purposes the date chosen, and the taxpayer may not later choose any other date unless he first obtains the permission of the Commissioner. A taxpayer choosing a date by claiming such a loss on a return, claim for refund, or petition (whether or not such choice was made before the enactment of the Revenue Act of 1942) cannot change such choice unless he obtains the permission of the Commissioner. A taxpayer requesting the permission of the Commissioner in order to choose a new date must submit the same information as is required under § 29.127 (a)–2 (c) in the case of a taxpayer changing his choice of date under section 127 (a) (1), and such permission will be granted if the proper adjustments in tax liability resulting from such change may be made. The choice of date by the taxpayer must be the same for all intangible property which relates to the same property treated as destroyed or seized under section 127 (a) (1) and (2). Thus, a taxpayer owning stock and bonds in a corporation, all the assets of which are in an area that comes under the control of the enemy, cannot under section 127 (a) (3) treat the stock as destroyed or seized on one date and the

bonds as destroyed or seized on another date.

If a taxpayer owns 100 percent (excluding qualifying shares) of each class of stock of a corporation, it may elect for the purposes of section 127 (a) (3) to determine the worthlessness of its interest in such corporation without regard to the amount of the property of such corporation which is money in the United States, bank deposits, the right to receive money from any person not situated in a country at war with the United States or in a territory under the control of such a country, and obligations issued or guaranteed as to principal or interest by the United States, except any of such property of the corporation which is treated as destroyed or seized under section 127 (a) (1), (2), or (3) during or before the taxable year of the taxpayer in which the war loss is claimed. This exclusion of certain property of the corporation in determining worthlessness is made both for the purpose of determining whether the interest of the taxpayer in the corporation is worthless and for the purpose of determining whether such interest would have become worthless if the underlying assets of the corporation treated as destroyed or seized under section 127 (a) (1) or (2) had been destroyed. Such election is made by claiming in a return, a claim for credit or refund of an overpayment, or a petition to The Tax Court of the United States a deduction for a loss which was actually sustained upon the destruction or seizure described in section 127 (a) (3) of any interest in such corporation. The election is made for the entire interest of the taxpayer in the corporation, whether represented by stock, bonds, or otherwise, and is so made even if the taxpayer claims the loss for only a part of such interest. Such election when once made is irrevocable, although the date chosen as the date when the loss occurred may be changed with the permission of the Commissioner as in the case of other losses from a destruction or seizure described in section 127 (a) (3). For treatment of the amount of property excluded in determining worthlesssness as a recovery by the taxpayer, see § 29.127 (b)–1.

For a loss to be sustained under section 127 (a) (3) with respect to any intangible property, such property must have a basis. Any intangible property treated as destroyed or seized under section 127 (a) (3) will, to the extent of the loss sustained upon such destruction or seizure, be treated as a casualty loss. Section 23 (g) (2) and (k) (2), relating to losses on certain worthless securities being treated as capital losses, does not apply to the loss on any such intangible property described in section 127 (a) (3), although such loss may, if the provisions of section 117 (j) are applicable, be treated as a capital loss under the provisions of section 117 (j). See § 29.117–7.

[SEC. 127. WAR LOSSES—as added by sec. 156 (a), Rev. Act 1942.]

(b) *Amount of loss on destroyed or seized property.* In the case of any property or interest in or with respect to property deemed to be destroyed or seized under subsection (a)—

(1) The amount of the loss on account of such property or interest shall be determined with regard to any recoveries with respect thereto in the taxable year but without regard to any possibility of recovering such property or interest, or of receiving any compensation (other than insurance or similar indemnity) on account of such property or interest in the taxable year or in any future taxable year.

(2) The taxpayer may choose to decrease the amount of the loss by all obligations or liabilities of the taxpayer with respect to such property or interest discharged or satisfied out of the property or interest upon its destruction or seizure, if the Commissioner is satisfied that such obligations or liabilities are so discharged or satisfied in a subsequent taxable year, or that the taxpayer is unable to determine whether or not such obligations or liabilities are in fact discharged or satisfied. No loss shall be deemed to have been sustained upon the destruction or seizure of such property or interest to the extent that it is compensated for by the discharge or satisfaction of obligations and liabilities of the taxpayer out of such property or interest in the taxable year in which such destruction or seizure is deemed to have occurred. The taxpayer's choice under this subsection shall be effective only if made within such time and in such manner as may be prescribed by regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.127 (b)–1 *Determination of amount of war loss.* The loss upon the property treated as destroyed or seized under section 127 (a) and (e) is determined as if the taxpayer's interest in such property had ceased by reason of such destruction or seizure. The loss is determined in the same manner as in the case of any other loss by casualty (see §§ 29.23 (e)–1 and 29.23 (f)–1 except that the possibility of recovering such property described in section 127 (a) or (e) or of recovering any compensation (other than insurance or similar indemnity) on account of such property or interest in the taxable year or in any future taxable year (such as the return of the property, or an award by a government, upon the termination of the war) is disregarded both in determining whether the loss is evidenced by a closed and completed transaction and in determining the amount of the loss. Insurance or any other certain indemnity by a government is not disregarded. If during the same taxable year in which the destruction or seizure is deemed to occur the taxpayer recovers the property, recovers money or other property in lieu of such property, or receives compensation for such property, or if during such taxable year the possibility of any such recovery or of receiving any such compensation develops into a recognized right to such recovery or compensation, such facts must be taken into account in determining whether any loss was sustained and, if a loss was sustained, the amount of the loss. For example, the taxpayer has property in an area under the control of an enemy country on the date war with such country is declared. Such property is deemed, under section 127 (a) (2), destroyed or seized on such date. During the taxable year of the taxpayer in which such date falls, the property is sent into a neutral country where the taxpayer recovers it. No loss is sustained by the taxpayer by reason of the destruction or seizure deemed to occur under section 127 (a) (2). If in lieu of such property the taxpayer had recovered other property in the same taxable year, the value of such other property must be taken into account as compensation for the loss sustained upon the destruction or seizure deemed to occur under section 127 (a) (2).

If a taxpayer owning 100 percent of each class of stock of a corporation elects under section 127 (a) (3) (see § 29.127 (a)–4) to determine the worthlessness of his interest in such corporation without regard to certain assets of the corporation as described in section 127 (a) (3), the entire value of such assets of the corporation as of the date the taxpayer's interest in the corporation is deemed destroyed or seized under section 127 (a) (3) shall be treated as a recovery on such date by the taxpayer in determining the amount of his loss upon such destruction or seizure. Obligations of the corporation enforceable against such assets are disregarded in determining the amount of such recovery. For example, if the corporation's interest in such assets is worth $100,000, the taxpayer's recovery under the provisions of section 127 (a) (3) is considered to be $100,000, regardless of whether or not any obligations of the corporation, enforceable against such assets, are superior to the interest of the taxpayer in the corporation. Thus, if the only interest of the taxpayer in the corporation is his ownership of its stock, and if the adjusted basis of such stock is $1,000,000, his loss is $900,000 even though the corporation may have $300,000 in outstanding bonds enforceable against such assets of $100,000 and against its other assets which were not treated as destroyed or seized under section 127. (It is assumed that the stock would not be worthless, and therefore a war loss under section 127 (a) (3), if the election under section 127 (a) (3) were not made.)

If, in the same taxable year in which the destruction or seizure of any property is deemed to occur, such property was used to discharge or satisfy any obligations and liabilities of the taxpayer, or if any such obligations and liabilities are discharged by reason of the events which cause such property to be treated as destroyed or seized, the amount of such compensation must be taken into account in determining the loss upon the destruction or seizure of the property. Furthermore, the taxpayer may elect to decrease the amount of his loss in the taxable year with respect to any property treated as seized or destroyed under section 127 by the amount of his other obligations and liabilities with respect to such property if such obligations or liabilities are discharged or satisfied in a subsequent taxable year out of such property or if the taxpayer is unable to determine at the time of the election whether or not such obligations or liabilities are so discharged or satisfied. The determination of the amount of the loss where there are obligations and liabilities with respect to destroyed or seized property is illustrated by the case of a bank having a branch in Rumania, the assets of which are treated under sec-

tion 127 (a) (2) as destroyed or seized on the date war is declared with Rumania. In determining the loss upon such assets, consideration must be given to the compensation for the destruction or seizure resulting from the assets being used in the same taxable year to discharge the bank's liabilities to depositors in the branch. Furthermore, if the bank establishes that any liabilities to depositors were discharged out of the assets in a subsequent taxable year, or if the bank establishes that it is unable to determine whether or not any such liabilities are discharged out of the assets, it may elect to decrease the amount of the loss with respect to the assets in the branch by all such liabilities. If it is determined that any liabilities will not be discharged out of the assets, the bank may not decrease the amount of the loss by the amount of such liabilities.

The election described above to decrease the amount of the loss by obligations and liabilities with respect to the destroyed or seized property is made by so decreasing the loss in claiming a deduction therefor in the return (or if such return was filed on or before March 15, 1943, in an amendment thereto filed on or before July 1, 1943), in a claim for credit or refund of an overpayment, or in a petition to The Tax Court of the United States with respect to the taxable year in which the loss was sustained, and by attaching to such return (or such amendment thereto filed on or before July 1, 1943) as a part thereof, or by including in such claim a statement as to the obligations and liabilities involved, the property to which they relate, and such facts as are in the taxpayer's knowledge. If the loss is claimed in a petition to The Tax Court, such statement, made under oath, should be attached to a copy of the petition and sent to the Commissioner of Internal Revenue, Washington, D. C. The election when once made may be changed only with the permission of the Commissioner. The election must be made as to all the obligations and liabilities described above with respect to the same property, and applies to all such obligations and liabilities if made as to any of them.

[SEC. 127. WAR LOSSES—as added by sec. 156 (a), Rev. Act 1942.]

(c) *Recoveries included in gross income*—(1) *General rule.* Upon the recovery in the taxable year of any money or property in respect of property considered under subsection (a) as destroyed or seized in any prior taxable year, the amount of such recovery shall be included in gross income to the extent provided in paragraph (2).

(2) *Amount of gain includible.* The amount of the recovery of any money or property in respect of property considered under subsection (a) as destroyed or seized shall be an amount equal to the aggregate of such money and the fair market value of such property, determined as of the date of the recovery. To the extent that such amount plus the aggregate of the amounts of previous such recoveries do not exceed that part of the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a) which did not result in a reduction of any tax of the taxpayer under this chapter, such amount shall not be includible in gross income and shall not be deemed gain upon the involuntary conversion of property as a result of its destruction or seizure. To the extent that such amount plus the aggregate of the amounts of previous such recoveries exceed that part of the aggregate of such deductions which did not result in a reduction of any tax of the taxpayer under this chapter and do not exceed that part of the aggregate of such deductions which did result in a reduction of any tax of the taxpayer under this chapter, such amount shall be included in gross income but shall not be deemed a gain upon the involuntary conversion of property as a result of its destruction or seizure. To the extent that such amount plus the aggregate of the amounts of previous such recoveries exceed the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a), such amount shall be considered a gain upon the involuntary conversion of property as a result of its destruction or seizure and shall be recognized or not recognized as provided in section 112 (f). If for any previous taxable year the taxpayer chooses under subsection (b) to treat any obligations and liabilities as discharged or satisfied out of the property or interest described in subsection (a), and if such obligations and liabilities were not so discharged or satisfied, the amount of such obligations and liabilities treated as discharged or satisfied under subsection (b) shall be considered for the purposes of this section as a deduction by reason of this section which did not result in a reduction of any tax of the taxpayer under this chapter. For the purposes of this paragraph an allowable deduction for any taxable year on account of the destruction or seizure of property described in subsection (a) shall, to the extent not allowed in computing the tax of the taxpayer for such taxable year, be considered an allowable deduction which did not result in a reduction of any tax of the taxpayer under this chapter.

(3) *Restoration of value of investments referable to destroyed or seized property.* For the purposes of paragraphs (1) and (2), the restoration in whole or in part of the value of any interest described in subsection (a) (3) by reason of any recovery of money or property in respect of property to which such interest related and which was considered under subsection (a) (1) or (2) as destroyed or seized shall be deemed a recovery of property in respect of property considered under subsection (a) as destroyed or seized.

§ 29.127 (c)–1 *Recoveries included in gross income.* A taxpayer who has sustained a war loss described in section 127 must include in his gross income for each taxable year, to the extent provided in section 127 (c), the amount of his recoveries of money and property for such taxable year in respect of any war loss in a previous taxable year. Section 127 (c) provides that such recoveries for any taxable year are not includible in income until the taxpayer has recovered an amount equal to his allowable deductions in prior taxable years on account of such war losses which did not result in a reduction of any tax under chapter 1 of the Internal Revenue Code, that is, of any income tax of the taxpayer. See § 29.127 (f)–1 for the determination of the amount of such deductions. Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of his allowable deductions in prior taxable years on account of war losses which did result in a reduction of any such tax under chapter 1. Any further recoveries in excess of all the taxpayer's allowable deductions in prior taxable years for war losses are treated as gain on an involuntary conversion of property as a result of its destruction or seizure, and such gain is recognized or not recognized under the provisions of section 112 (f). See § 29.112 (f)–1. Such gain, if recognized, is included in gross income as ordinary income unless section 117 (j) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See § 29.117–7.

The amount of the recovery of any money or property in respect of any war loss is the aggregate of the amount of such money and of the fair market value of such property, both determined as of the date of the recovery. The recoveries in respect of any war loss include the recovery of the property or interest treated as destroyed or seized under section 127 and the recovery of any money or property in lieu of such property or interest or on account of the destruction or seizure of such property or interest. For example, there is a recovery upon the return to the taxpayer after the termination of the war of his property which was treated as resulting in a war loss because it was located in a country at war with the United States. An award by a government on account of the seizure of the taxpayer's property by an enemy country is a recovery under section 127 (c). The amount obtained upon the sale or other transfer by the taxpayer of his right to any property treated as resulting in a war loss is also a recovery for the purposes of section 127 (c). Similarly, if a taxpayer who sustained a war loss under section 127 (e) upon the liquidation of a corporation has received the rights to any property of the corporation which was treated as destroyed or seized under section 127 (a) (1) or (2), any recovery by the taxpayer with respect to such rights is a recovery by him for the purposes of section 127 (c). Furthermore, if any interest of the taxpayer in or with respect to property was determined to be worthless and was treated as a war loss under section 127 (a) (3) (see § 29.127 (a)–4), or if the taxpayer retained an interest in a corporation with respect to which he sustained a war loss under section 127 (e), and if the interest in the hands of the taxpayer is restored in value, in whole or in part, by reason of a recovery with respect to the underlying assets treated as destroyed or seized under section 127, then such restoration in value is a recovery by the taxpayer for the purposes of section 127 (c).

The determination as to whether and to what extent any recoveries are to be included in gross income is made upon the basis of the amount of all the recoveries for each day upon which there are any such recoveries, as follows:

(a) The amount of the recoveries for any day is not included in gross income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of the allowable deductions in prior taxable years on account of war losses which did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code, as determined under

§ 29.127 (f)–1, exceeds the amount of all previous recoveries in the same and prior taxable years.

(b) The amount of the recoveries for any day which is not excluded from gross income under (a) is included in gross income as ordinary income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of all the allowable deductions in prior taxable years on account of war losses (both those which resulted in a reduction of a tax of the taxpayer and those which did not) exceeds the sum of the amount of all previous recoveries in the same and prior taxable years and of that portion, if any, of the amount of the recoveries for such day which is not included in gross income under (a).

(c) The amount of the recoveries for any day which is not excluded from gross income under (a) and is not included in gross income as ordinary income under (b) is considered gain on an involuntary conversion of property as a result of its destruction or seizure. The following provisions then apply to this gain:

(1) Such gain is recognized or not recognized under the provisions of section 112 (f), relating to gain upon such conversion of property. For the purpose of applying section 112 (f), such gain for any day is deemed to be expended in the manner provided in section 112 (f) to the extent the recovery for such day is so expended.

(2) If such gain is recognized it is included in gross income as ordinary income or, if the provisions of section 117 (j) apply and require such treatment, as gain on the sale or exchange of a capital asset held for more than six months. For the purpose of applying section 117 (j), such recognized gain for any day is deemed to be derived from property described in that section to the extent of the recovery for such day with respect to such property, except such portion of such recovery as is attributable to the nonrecognized gain for such day.

(3) Section 127 (d) provides that in determining the unadjusted basis of recovered property, the total gain and the recognized gain with respect to such property must be determined. For such purposes, the recognized gain deemed to be derived from properties described in section 117 (j) may be allocated among such properties in the proportion of the recoveries with respect to such properties, reduced for each property by the portion of the recovery attributable to the nonrecognized gain for such day, and the recoveries with respect to properties not described in section 117 (j) may be similarly allocated. The total gain derived from any recovered property is the sum of the nonrecognized gain attributable to the recovery of such property and of the recognized gain allocable to such property.

The foregoing provisions may be illustrated by the following examples:

Example (1). The taxpayer sustained war losses of $3,000 on account of properties A, B, C, and D. Of this amount, $1,000 did not result in a reduction of any income tax of the taxpayer, as determined under the provisions of § 29.127 (f)–1. In a subsequent taxable year, he received an award of $800 from the Government on account of property A. This is not included in income since it is less than the amount by which his allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit, $1,000, exceed $0, the sum of all his previous recoveries. On a later date the taxpayer recovers property B, which is worth $1,500 on the date of recovery. This recovery is not included in gross income to the extent of $200, the amount by which the allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit, or $1,000, exceed the sum of all previous recoveries, or $800. All of the remaining $1,300 of the recovery is included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, since it is less than the amount by which the aggregate of all the allowable deductions in prior taxable years on account of war losses, or $3,000, exceeds $1,000, the sum of the $800 of previous recoveries and of the $200 portion of the recovery with respect to B which is not included in gross income. On a still later date the taxpayer sells for $2,500 his rights to recover C. Since the allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit ($1,000) do not exceed the previous recoveries by the taxpayer ($800 and $1,500, or $2,300), note of the recovery on account of C is excluded from gross income. This recovery is included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, to the extent of $700, the amount by which the aggregate of all the allowable deductions for prior taxable years on account of war losses ($3,000) exceeds $2,300, the sum of the $2,300 of previous recoveries and of the $0 portion of the recovery on account of C which is not included in gross income. The remaining $1,800 of the recovery is considered gain on an involuntary conversion of property on account of its destruction or seizure, and is not recognized if forthwith expended in the manner provided in section 112 (f). Thus, it is not recognized if it is forthwith expended for the acquisition of property related in service or use to C. On a later date the taxpayer recovers D, which has a fair market value of $400 at the time of the recovery. Since the aggregate of all the allowable deductions for prior taxable years on account of war losses ($3,000) does not exceed the previous recoveries by the taxpayer ($800+$1,500+$2,500, or $4,800), all of the recovery with respect to D is considered gain on an involuntary conversion of property as a result of its destruction or seizure. Under the provisions of section 112 (f), this gain is not recognized if D is used for the same purposes for which it was used before it was deemed destroyed or seized under section 127.

Example (2). The taxpayer on one day recovers $3,000 for property A and $7,000 for property B, both of which were treated under section 127 as destroyed or seized in a prior taxable year, and $8,000 of such $10,000 recoveries is considered gain on the involuntary conversion of property as a result of its destruction or seizure. The taxpayer forthwith expends $5,000 in the acquisition of property similar in use to B. Therefore, $5,000 of the $8,000 gain is not recognized under section 112 (f), leaving $3,000 of recognized gain. Property B is within the provisions of section 117 (j), relating to gains and losses on the involuntary conversion of certain described property, but property A is not. Therefore, the provisions of section 117 (j) apply to $2,000 of the $3,000 gain, that is, the amount of the recovery with respect to B which is not attributable to the nonrecognized gain for such day ($7,000 minus $5,000). If the taxpayer forthwith expended $8,000 or more for the acquisition of property similar in use to B, none of the gain would be recognized. If the taxpayer forthwith expended the $5,000 to acquire property related in use to A, the $3,000 recognized gain would be considered derived from B to the extent of the recovery with respect to B ($7,000), not reduced by any nonrecognized gain since none of such recovery is attributable to such nonrecognized gain, and therefore all of the $3,000 recognized gain would be subject to the provisions of section 117 (j).

For the purposes of section 127 (c), the recoveries considered are only those with respect to war losses sustained in prior taxable years. Similarly, the only deductions considered are those allowable for prior taxable years, and any allowable deductions for the year of the recovery are ignored for the purposes of applying such section to the recovery. If property is treated as destroyed or seized under section 127, and if in the same taxable year there is also a recovery with respect to such property, such recovery is not within the provisions of section 127 (c) but is taken into account under section 127 (b) in determining the amount of the loss, if any, on the destruction or seizure. See § 29.127 (b)–1. An allowable deduction with respect to a war loss is any deduction to which the taxpayer is entitled on account of any property or interest being treated as destroyed or seized under section 127, regardless of whether or not such deduction was claimed by the taxpayer or otherwise allowed in computing his tax. If a deduction was claimed by a taxpayer in computing his tax for any taxable year, and if such deduction was disallowed, such deduction will not be considered an allowable deduction for such taxable year since the previous determination will not be reconsidered.

[Sec. 127. WAR LOSSES—as added by sec. 156 (a), Rev. Act 1942.]

(d) *Basis of recovered property.* The unadjusted basis of property recovered in respect of property considered destroyed or seized under subsection (a) shall be determined under this subsection. Such basis shall be an amount equal to the fair market value of such property, determined as of the date of the recovery, reduced by an amount equal to the excess of the aggregate of such fair market value and the amounts of previous recoveries of money or property in respect of property considered under subsection (a) as destroyed or seized over the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a), and increased by that portion of the amount of the recovery which under subsection (c) is treated as a recognized gain from the involuntary conversion of property. Upon application of the taxpayer, the aggregate of the bases (determined under the preceding sentence) or any properties recovered in respect of properties considered under subsection (a) as destroyed or seized may be allocated among the properties so recovered in such manner as the Commissioner may determine under regulations prescribed by him with the approval of the Secretary, and the amounts so allocated to any such property so recovered shall be the unadjusted basis of such property in lieu of the unadjusted basis of such property determined under the preceding sentence.

§ 29.127 (d)–1 *Basis of recovered property.* Under section 127 (d), the unadjusted basis of any property treated as a war loss under section 127 which is recovered and the unadjusted basis of any property which is recovered in lieu of or on account of any such war loss is considered the fair market value of such recovered property upon the date of its recovery with the following adjustments:

(a) If the sum of the recoveries for the day such property is recovered and of

all previous recoveries exceeds the aggregate of the allowable deductions for prior taxable years on account of war losses, so that a portion of the recoveries for such day is treated as gain on the involuntary conversion of property, such fair market value of the property is reduced by the total gain, if any, for such day derived from such recovered property, as determined under § 29.127 (c)–1.

(b) Such fair market value, as reduced under (a) above, is increased by the portion, if any, of the recognized gain resulting from the recoveries for such day which is allocable to such recovered property, as determined under § 29.127 (c)–1.

In effect, the unadjusted basis of such property is its fair market value upon the date of its recovery, reduced by the amount of nonrecognized gain attributable to such recovery under the provisions of § 29.127 (c)–1.

If the respective bases of several properties of a taxpayer determined under section 127 (d) are greatly disproportionate to their adjusted bases immediately prior to their being treated as destroyed or seized under section 127, the taxpayer may apply to the Commissioner for the allocation of the aggregate of the bases of such properties among them in the proportion of their adjusted bases immediately prior to the destruction or seizure of such properties determined under section 127. The amount so allocated to any such property, in an application approved by the Commissioner, shall be the unadjusted basis of such property in lieu of the amount determined under the preceding paragraph.

The application to the Commissioner shall set forth a list of all the properties of the taxpayer having an unadjusted basis determined under this section, a description of each such property together with a statement as to the amount of its adjusted basis immediately prior to the destruction or seizure of such property determined under section 127, and a statement as to whether there has been any substantial change in the use or nature of the property chosen for the allocation from its nature or use immediately prior to the time it was treated as destroyed or seized. Such application will be allowed unless there has been such a substantial change in the nature or use of such property that the allocation of the bases would produce an arbitrary result, or unless the taxpayer has obtained such tax benefits by reason of the basis determined under the first paragraph of this section that it would be inequitable to change his basis. Thus, the allocation will not be allowed if it would give the taxpayer an unadjusted basis with respect to any property which is less than the amount of the adjustments in reduction of the basis of such property which are allowable after its recovery. For example, when property A is recovered it has an unadjusted basis of $100. After $70 depreciation has been allowed on A, an allocation is sought which would give A an unadjusted basis of $60. Since this is less than the depreciation which is an adjustment against such basis, the allocation will not be permitted.

The amount of any adjustments to the unadjusted basis determined under the first paragraph of this section shall, upon the allocation of the bases, be taken as an adjustment to the allocated unadjusted basis. Thus, if $30 depreciation was allowed upon a $100 basis determined under the first paragraph of this section, and if the unadjusted basis upon allocation is $75, such $30 depreciation is allowed against such allocated unadjusted basis, so that the adjusted basis of the property is then $45.

The taxpayer may choose any group of recovered properties for allocation, except that if any such recovered properties form one economic unit, such properties may not be separated but all or none must be included in the group. For example, a building may not be separated from the land on which it stands if both are recovered property, nor may one block of stock in a corporation be separated from other stock in such corporation or from bonds in such corporation which are also treated as a recovery. If the taxpayer has once been permitted to allocate the bases of any group of properties, he may obtain another allocation with respect to such properties only if all the properties in the original group are included together with other recovered properties not included in the original group. For example, if the bases of properties A and B are allocated, a second allocation will be made for properties A, B, and C, but not for A and C or B and C.

[SEC. 127. WAR LOSSES—as added by sec. 156 (a), Rev. Act 1942.]

(e) *Partial worthlessness of certain investments in destroyed or seized property*—(1) *Destruction or seizure or investment.* If a taxpayer owns not less than 50 per centum of each class of stock of a corporation, if such corporation has property described in subsection (a) (1) or (2) deemed to be destroyed or seized, the adjusted basis for determining loss of which is at least 75 per centum of the adjusted basis for determining loss of all such corporation's property, and if such corporation completely liquidates (by distributing all the assets which it is able to distribute and all its rights to assets which it is not able to distribute, including the right to the recovery of the property described in subsection (a) (1) and (2)) within one year after such property is deemed to be destroyed or seized, or within six months after the date of the enactment of the Revenue Act of 1942, whichever is the later, then that part of the loss by the taxpayer on such liquidation which would be attributable to the destruction or seizure of such property, as established to the satisfaction of the Commissioner, shall be treated for the purposes of this chapter as a loss by the taxpayer upon the destruction or seizure of the part of the stock or other interest of the taxpayer to which such loss is allocable. Such part of the stock or other interest of the taxpayer shall be treated for the purposes of subsections (b), (c), and (d) as property described in subsection (a) (3).

(2) *Application of paragraph* (1)—For the purposes of paragraph (1)—

(A) In determining the adjusted basis of all the property of the corporation, there shall be excluded money in the United States, bank deposits, the right to receive money from any person not situated in a country at war with the United States or in a territory under the control of such a country, and obligations issued or guaranteed as to principal or interest by the United States, except that there shall not be excluded any such property which is destroyed or seized as described in subsection (a) within or before the taxable period.

(B) The adjusted basis of property of such corporation shall be determined as of the date immediately preceding the first date on which any property was destroyed or seized, as described in subsection (a), or as of any later date falling within or before the taxable period on the basis of which such determination will produce a greater amount.

§ 29.127 (a)–1 *Cases in which liquidation of corporation causes war loss.* Section 127 (e) provides that in a limited class of cases a portion of the loss by a taxpayer upon the liquidation of a corportion will be treated as a war loss resulting from the destruction or seizure of an allocable part of the interest of the taxpayer in the corporation. The war loss is sustained at the time the loss upon the liquidation is sustained. The taxpayer sustains a war loss only if section 127 (e) applies to the loss sustained by him upon the liquidation of the corporation, and only in the amount determined under that section. The provisions of section 127 (b), (c), and (d), and the regulations thereunder, which apply to a war loss determined under section 127 (a) (3) also apply to a war loss determined under section 127 (e).

(a) *Application of section* 127 (e). Section 127 (e) applies only if all of the following provisions are met:

(1) The taxpayer must own not less than 50 percent of each class of stock of the corporation at the time of the liquidation described below and at all times when any property of the corporation described in section 127 (a) is deemed destroyed or seized.

(2) Property of the corporation representing at least 75 percent of the adjusted basis for determining loss of all the property of the corporation must be deemed destroyed or seized under the provisions of section 127 (a) (1) or (2), relating to property actually destroyed or seized during military or naval operations or located in an enemy country or in an area under the control of such country. For the purposes of this provision:

(i) The adjusted basis for determining loss of all the property of the corporation is determined as of the date immediately preceding the first date on which any property of the corporation is deemed destroyed or seized under the provisions of section 127 (a) (1), (2), or (3), except that if such determination would produce a greater amount if made as of any later date falling within or before the taxable year in which the loss is sustained, it is made as of such later date on which it produces the greatest amount. If any property of the corporation which is at no time treated as destroyed or seized under section 127 (a) is money in the United States, bank deposits, the right to receive money from any person not situated in a country at war with the United States or in a territory under the control of such a country, or obligations issued or guaranteed as to principal or interest by the United States, then the

adjusted basis of such property shall not be taken into account in determining the adjusted basis of all the property of the corporation.

(ii) The property of the corporation described in section 127 (a) (1) or (2) deemed to be destroyed or seized represents at least 75 percent of the amount determined under (i) above as the adjusted basis for determining loss of all the property of the corporation if the aggregate of the adjusted bases for determining loss of all such property described in section 127 (a) (1) or (2) (determined for each such property as of the date prescribed under (i), except that the date immediately preceding the date it is deemed destroyed or seized shall be used if the property was not held by the corporation on the date prescribed in (i) or was deemed destroyed or seized on or before such date) is not less than 75 percent of the amount so determined under (i). The property described in section 127 (a) (1) or (2) which is included in determining such 75 percent amount is property owned by the corporation, for the destruction or seizure of which it could claim a war loss under section 127 (a) (1) or (2). Property of the corporation deemed destroyed or seized under section 127 (a) (3) is not included in determining such 75 percent amount even though such property may be an interest in property described in section 127 (a) (1) or (2).

(3) The corporation must completely liquidate within one year after the last property of the corporation described in section 127 (a) (1) or (2) is deemed destroyed or seized under such section, except that if such year expires before April 21, 1943 (the last date falling within six months after the enactment of the Revenue Act of 1942), the liquidation may be completed on or before that date. The corporation has completely liquidated if it has distributed to its shareholders all the assets which it is able to distribute and all its rights to assets, such as assets treated as war losses under section 127 (a) (1) or (2), which it is not able to distribute. Dissolution of the corporation is not necessary if the distribution otherwise results in a complete liquidation. In some cases the corporation may not be able to comply with certain formalities required by the law applicable in the case of a liquidation. For example, a corporation chartered by a foreign government not at war with the United States may be required to hold its shareholders' meetings, at which any liquidation must be approved, in a city occupied by the forces of a country at war with such government and with the United States; due to the occupation of that city by the enemy country the shareholders' meeting, approving the liquidation, is held at some other place. In such cases, the validity of the liquidation will be determined on the basis of whether the corporation in good faith has complied as fully as possible with all provisions of law applicable to such liquidation. The liquidation will not be considered invalid because of the absence of any formalities incident to such liquidation with which the corporation was not able to comply, unless such liquidation is actually declared invalid by any appropriate authority. If a war loss upon any such liquidation has been allowed upon audit by the Commissioner, if the taxpayer attached a statement to the return in which such loss was claimed, as a part thereof, to the effect that he had determined to consider the liquidation valid for all purposes, including the treatment as a recovery by him for the purposes of section 127 (c) of any recovery with respect to the assets and rights to assets distributed to him, and if the taxpayer in such statement waived the benefits of any period of limitations which would prevent the adjustment of his tax liability on account of the invalidity of the liquidation at any time at which he should contend that the liquidation was invalid and the Commissioner should agree to permit him so to change his position, then (in the absence of such change of position with the permission of the Commissioner) the war loss will not be subsequently disallowed even though the liquidation may be declared invalid by some appropriate authority.

(b) *Determination of amount of war loss.* If the provisions of paragraph (a) of this section are met, the loss sustained by the taxpayer upon the liquidation described in such paragraph is considered a war loss to the extent it is attributable to the property of the corporation described in section 127 (a) (1) or (2) which is deemed destroyed or seized. The loss sustained by the taxpayer upon the liquidation of the corporation is attributable to property of the corporation described in section 127 (a) (1) or (2), which is deemed destroyed or seized, to the extent that such loss would be decreased (but not decreased below zero) if the corporation at the time of the liquidation owned additional assets, which it could distribute, having a fair market value equal to that of the property described in section 127 (a) (1) or (2), determined for each such property as of the date immediately preceding the date it is deemed destroyed or seized. The amount of the war loss sustained by the taxpayer is the amount of such decrease. For example, a taxpayer decribed in paragraph (a) of this section sustained a loss of $1,000 upon a liquidation described in such subsection. If the corporation owned additional distributable assets at the time of the liquidation having a fair market value equal to that of its property described in section 127 (a) (1) or (2) (determined as of the date immediately preceding the date such property is deemed destroyed or seized), it would have distributed $800 of such assets to the taxpayer, and his loss upon the liquidation would accordingly have been reduced by this amount. Therefore, $800 of the $1,000 loss sustained by the taxpayer is attributable to the property of the corporation described in section 127 (a) (1) or (2), and the taxpayer has a war loss of $800. The remaining $200 loss sustained on the liquidation has the same character it would have had if section 127 (e) had not applied to any portion of such loss.

If the taxpayer has more than one kind of stock or other interest in the corporation, the determination of the war loss by reference to the decrease in the loss on the liquidation must be made for each such interest, since to the extent the loss on any such interest would be reduced below zero (by the distribution of the assets equal in value to the property described in section 127 (a) (1) or (2)) no war loss is sustained by the taxpayer. For example, the taxpayer owns stock A and stock B in the corporation, and upon its liquidation he sustains a loss of $1,000 with respect to A and of $2,000 with respect to B, or $3,000 in all. Upon a distribution of assets equal in value to the property of the corporation described in section 127 (a) (1) or (2), the taxpayer would receive $1,800, reducing his loss on the liquidation by that amount. However, of this $1,800, $1,200 would be received with respect to the A stock, for which the loss on the liquidation was only $1,000. Therefore, only $1,000 of the amount received with respect to the A stock is a war loss. $600 would be received with respect to the B stock, and all of this amount is a war loss since it would not reduce the $2,000 loss on B below zero. Therefore, the war loss of the taxpayer on the liquidation is $1,600 ($1,000 plus $600) and not the $1,800 computed on the basis of the taxpayer's total interest in the corporation.

For the purposes of the preceding paragraphs of this paragraph, the loss sustained by the taxpayer upon the liquidation described in paragraph (a) of this section is determined under sections 111 and 115. Such loss is determined without regard to the provisions of section 112, relating to the nonrecognition of gains and losses upon certain exchanges, but such provisions apply to that part of the loss which is not treated as a war loss. In determining the loss of the taxpayer upon the liquidation, no value shall be ascribed to the possibility of a recovery of the property of the corporation described in section 127, deemed destroyed or seized, the rights to which are distributed to him, or of compensation (other than insurance or similar indemnity) on account of its destruction or seizure. Any recovery in the taxable year with respect to such rights is taken into account under section 127 (b) in determining the amount deductible on account of the war loss.

The war loss described in this section is deemed to result from the destruction or seizure of the taxpayer's interest in the corporation to which it is allocable. Therefore, this war loss, in the amount determined under section 127 (b) (see § 29.127 (b)–1), is deductible as an ordinary loss by casualty unless under section 117 (j), relating to losses on the involuntary conversion of certain property, it is treated as a loss on the sale or exchange of a capital asset. If part of the taxpayer's stock or other interests in the corporation is property described in section 117 (j), and part is not, then for the purposes of section 117 (j) the war loss must be allocated to the various interests in the corporation. The portion

of any interest in the corporation to which any part of the war loss is allocable is deemed destroyed or seized under section 127 (e), and the part of the war loss allocated to such interest is deemed to result from such destruction or seizure. The allocation of the war loss among the stock and other interests of the taxpayer in the corporation is made as follows:

The war loss is apportioned among the stock and other interests of the taxpayer in the corporation in the amounts by which the losses with respect to such interests, sustained upon the liquidation, would be decreased if the corporation had distributed, as described above for the determination of the amount of the war loss, assets equal in value to its property described in section 127 (a) (1) or (2). The war loss is allocable to that part of the stock or other interest of the taxpayer which is the same portion of such interest as the war loss apportioned to such interest is of the loss with respect to such interest sustained upon the liquidation.

For example, the taxpayer owns stock of class A and stock of class B in a corporation. Upon the liquidation described in paragraph (a) of this section it sustains a loss of $1,000 on the A stock and $2,000 on the B stock, a total loss of $3,000. If the corporation had distributed assets equal in value to its property described in section 127 (a) (1) or (2), the taxpayer would have received $1,400, $1,000 with respect to A and $400 with respect to B, reducing his loss on each by such amount. Therefore, of his $1,400 war loss, $1,000 is apportioned to A and $400 to B. The war loss is allocable to all of the A stock $\left(\frac{\text{\$1,000 war loss}}{\text{\$1,000 liquidation loss}} \text{ times A}\right)$, and the $1,000 war loss apportioned to the A stock is deemed to result from its destruction or seizure. Similarly, the war loss is allocable to 20 percent of the B stock $\left(\frac{\text{\$400 war loss}}{\text{\$2,000 liquidation loss}} \text{ times B}\right)$, and the $400 war loss apportioned to B is deemed to result from the destruction or seizure of a 20 percent interest in the B stock owned by the taxpayer.

[SEC. 127. WAR LOSSES—as added by sec. 156 (a), Rev. Act 1942.]

(f) *Determination of tax benefits.* The determination as to whether and to what extent an allowable deduction on account of the destruction or seizure of property described in subsection (a) did or did not result in a reduction of any tax of the taxpayer under this chapter shall be made in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.127 (f)–1 *Determination of tax benefits from allowable deductions.* That part of the aggregate of the deductions allowed a taxpayer for any taxable year on account of war losses under section 127 which, if disallowed, would not result in an increase in the normal tax, surtax (including the tax imposed by section 102), or victory tax of the taxpayer, or of any tax imposed in lieu of such taxes, for the taxable year in which such deductions are allowed or in any other taxable year, such as a taxable year in which the taxpayer's income tax is computed by reference to a carry-over or carry-back of net operating losses from the taxable year in which such deductions are allowed, is considered for the purposes of section 127 an allowable deduction for the taxable year which did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code. In determining that part of the aggregate of the deductions on account of war losses which, if disallowed, would not result in an increase in any such income tax of the taxpayer, there shall first be excluded for each taxable year affected the deductions and credits on account of the bad debt, tax, and delinquency amounts which under section 22 (b) (12) and the regulations thereunder are treated as not resulting in a tax benefit. The deductions allowed a taxpayer for any taxable year on account of war losses are all the deductions on account of war losses which were claimed by the taxpayer in a return, in a claim for credit or refund of an overpayment, or in a petition to The Tax Court of the United States with respect to such taxable year and which were not disallowed, and all deductions on account of war losses which, although not so claimed by the taxpayer, were nevertheless allowed (for example, by the Commissioner, a court, or The Tax Court) in computing a tax of the taxpayer.

Any deduction allowable for a taxable year on account of a war loss under section 127 which (a) was not claimed by the taxpayer for such year in a return, a claim for credit or refund of an overpayment, or a petition to The Tax Court of the United States and (b) was not allowed as a deduction (for example, by the Commissioner, a court, or The Tax Court) in computing his tax for such year or for any other year is considered a deduction which did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code, since it is an allowable deduction which was not allowed in computing any tax of the taxpayer. If the taxpayer claimed for any taxable year a deduction on account of a war loss, and if such deduction was disallowed, the taxpayer may not subsequently contend for the purposes of section 127 (c) that such deduction was an allowable deduction for such taxable year.

If the taxpayer elected under section 127 (b) to decrease the amount of a war loss by treating the obligations and liabilities described in that section as discharged or satisfied out of the property destroyed or seized, and if the taxpayer establishes that any of the obligations and liabilities were not so discharged or satisfied, then the amount by which such continuing obligations and liabilities decreased the war loss shall be considered an allowable deduction for the taxable year in which the war loss was sustained which did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code.

SEC. 128. RECOVERY OF UNCONSTITUTIONAL FEDERAL TAXES [as added by sec. 157 (a), Rev. Act 1942].

Income (excluding interest) attributable to the recovery during the taxable year of a tax imposed by the United States which has been held unconstitutional, and in respect of which a deduction was allowed in a prior taxable year may be excluded from gross income for the taxable year, and the deduction allowed in respect thereof in such prior taxable year treated as not having been allowable, if—

(a) The taxpayer elects in writing (at such time and in such manner as may be prescribed by regulations prescribed by the Commissioner with the approval of the Secretary) to treat such deduction as not having been allowable for such prior taxable year, and

(b) The taxpayer consents in writing to the assessment, within such period as may be agreed upon, of any deficiencies resulting from such treatment, even though the statutory period for the assessment of any such deficiency had expired prior to the filing of such consent.

§ 29.128–1 *Recovery of unconstitutional taxes*—(a) *In general.* Subject to to the limitations herein, a taxpayer who recovers unconstitutional Federal taxes, such as taxes imposed by the Agricultural Adjustment Act, which were paid or accrued and for which a deduction was allowed in a prior taxable year is entitled at his election (see paragraph (b) of this section) to exclude the income (exclusive of interest) attributable to such recovery from his gross income in the taxable year of recovery.

In the event a taxpayer elects to receive the benefits of section 128 the income (exclusive of interest) attributable to the recovery of the unconstitutional Federal tax will be treated as an offset to the deduction allowed therefor in prior taxable years. The taxpayer's return for the prior taxable year or years with respect to which the statutory period for the assessment of a deficiency has expired will be opened only for the purpose of reducing the deduction allowed for the unconstitutional Federal tax and assessing the resulting deficiency or deficiencies, if any, and only if the taxpayer consents in writing to the assessment (see paragraph (b) of this section). No other adjustment will be allowed.

In the event the disallowance of the deduction allowed in respect of a prior taxable year results in a deficiency for that year, the deficiency will be assessed within the period agreed upon between the taxpayer and the Commissioner, in respect of the taxable year of the prior deduction, against the taxpayer (who must file a written consent to the assessment as provided in paragraph (b) of this section) even though the statutory period for the assessment may have expired prior to the filing of the consent.

If a taxpayer does not elect under the provisions of section 128 to exclude the tax recovered from gross income in the taxable year of recovery, the tax recovered shall from the standpoint of its inclusion in or exclusion from gross income be governed by the provisions of section 22 (b) (12).

Where a taxpayer's liability for income tax with respect to the deduction or the recovery or with respect to the tax liability for the year of the deduction or recovery has been finally determined by a written agreement or by a decision of The Tax Court of the United States or of any court, the taxpayer will not be entitled to the benefits of section 128 or of this section. As to taxability of refund of taxes generally, see section 22 (b) (12).

(b) *Manner of making election.* The election provided for in paragraph (a)

of this section shall be made by the taxpayer filing with the Commissioner a statement in writing that he elects to treat the deduction allowed in a prior taxable year for the unconstitutional tax as not having been allowable for such taxable year. Such a statement must be filed with the taxpayer's return for the taxable year in which the recovery of the unconstitutional tax or taxes occurs. Where the recovery antedates February 10, 1943 (the date of approval of Treasury Decision 5226), the statement of election must be filed within 90 days after such approval date. No other method of making the election is permitted. The statement of election must contain a description of the tax recovered, the date of recovery, the taxable year in which paid or accrued and the taxable year for which the deduction was allowed. The statement of election must also contain a statement signifying the taxpayer's consent (1) to the Commissioner's treating the deduction or portion thereof allowed in a prior year with respect to the unconstitutional tax as not allowable for that year and (2) to the Commissioner's assessing, in respect of the taxable year for which the deduction was allowed, any deficiency, together with interest thereon as provided by law, resulting from disallowance of the deduction or portion thereof, even though the statutory period for the assessment of any such deficiency may have expired prior to the filing of such consent.

As used in this section the term "recovery" includes not only refund or credit of taxes previously paid, but includes also the cancellation of a purported tax liability which was accrued and deducted for a prior taxable year but never actually paid.

CREDITS AGAINST TAX

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES [as amended by sec. 216, Rev. Act 1939; secs. 158 (a) (d) (e) (f), 172 (d), Rev. Act 1942].

(a) *Allowance of credit.* If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102 or section 450, shall be credited with:

(1) *Citizens and domestic corporations.* In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) *Resident of United States.* In the case of a resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) *Alien resident of United States.* In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) *Partnerships and estates.* In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

Such choice may be made or changed at any time prior to the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter.

(b) *Limit on credit.* The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income, in the case of a taxpayer other than a corporation, or to the sum of the normal-tax net income and the amount of the credit for adjusted excess profits net income provided in section 26 (e), in the case of a corporation, for the same taxable year; and

(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire net income, in the case of a taxpayer other than a corporation, or to the sum of the normal-tax net income and the amount of the credit for adjusted excess profits net income provided in section 26 (e), in the case of a corporation, for the same taxable year.

(c) *Adjustments on payment of accrued taxes.* If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner, who shall redetermine the amount of the tax for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 322. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as the Commissioner may require, conditioned upon the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(d) *Year in which credit taken.* The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(e) *Proof of credits.* The credits provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner (1) the total amount of income derived from sources without the United States, determined as provided in section 119, (2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this section, such amount to be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary, and (3) all other information necessary for the verification and computation of such credits.

(f) *Taxes of foreign subsidiary*—(1) *Foreign subsidiary of domestic corporation.* For the purposes of this section, a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid which the amount of such dividends bears to the amount of such accumulated profits: *Provided*, That the amount of tax deemed to have been paid by such domestic corporation under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the normal-tax net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subsection shall be construed to mean such accounting period.

(2) *Foreign subsidiary of foreign corporation.* If such foreign corporation owns all the voting stock (except qualifying shares) of another foreign corporation from which it receives dividends in any taxable year it shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such other foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of the corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits.

(g) *Corporations treated as foreign.* For the purposes of this section the following corporations shall be treated as foreign corporations:

(1) A corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its gross income from sources within a possession of the United States;

(2) A corporation organized under the China Trade Act, 1922, 42 Stat. 849 (U.S.C., Title 15, c. 4), and entitled to the credit provided for in section 262.

(h) *Credit for taxes in lieu of income, etc., taxes.* For the purposes of this section and section 23 (c) (1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States.

(i) *Tax withheld at source.* For the purposes of this supplement the tax imposed by this chapter shall be the tax computed without regard to the credit provided in section 32 and section 466 (e).

§ 29.131–1 *Analysis of credit for taxes.* If the taxpayer chooses to claim a credit for taxes, the basis of such credit, in the case of a citizen of the United States,

whether resident or nonresident, and in the case of a domestic corporation, is as follows: (1) The amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and (2) an individual's proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

In the case of an alien resident of the United States who chooses to claim a credit for such taxes the basis of the credit is as follows: (1) The amount of any such taxes paid or accrued during the taxable year to any possession of the United States; (2) the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country, and (3) his proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to any possession of the United States, or to any foreign country, as the case may be, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country.

If a taxpayer chooses to claim a credit for taxes, such action will be considered to apply to income, war-profits, and excess-profits taxes paid to all foreign countries and possessions of the United States, and no portion of any such taxes shall be allowed as a deduction from gross income.

The choice available to the taxpayer with respect to claiming such credit may be exercised (or changed if previously exercised) by the taxpayer at any time prior to the expiration of the period prescribed by statute for the making of a claim for credit or refund for the taxable year. For disallowance as a deduction of foreign income, war-profits, or excess-profits taxes in the event such choice is made, see § 29.23 (c)–1.

For taxable years beginning before January 1, 1943, no credit for taxes shall be allowed against the tax imposed under section 102, relating to surtax on corporations improperly accumulating surplus, and for taxable years beginning after December 31, 1942, credit for taxes shall be allowed neither against the tax imposed under section 102, relating to surtax on corporations improperly accumulating surplus, nor against the victory tax imposed under section 450.

A citizen of the United States or a domestic corporation entitled to the benefits of section 251, or a China Trade Act corporation, is not allowed any of the credits provided by section 131.

§ 29.131–2 *Meaning of terms.* The term "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. For the purposes of section 131 and section 23 (c) (1) the term "income, war-profits, and excess-profits taxes" includes a tax imposed by statute or decree by a foreign country or by a possession of the United States if (1) such country or possession has in force a general income tax law, (2) the taxpayer claiming the credit would, in the absence of a specific provision applicable to such taxpayer, be subject to such general income tax, and (3) such general income tax is not imposed upon the taxpayer thus subject to such substituted tax. For example, the A Corporation does business in the X country, which imposes an income tax upon substantially a net income base. The ascertainment of net income, though not the determination of gross income, from sources in X country is found administratively difficult. The X country, by decree, provides that corporations circumstanced as was the A Corporation would, in lieu of the income tax at the rate of 20 percent otherwise payable, be subject to tax at the rate of 10 percent upon the amount of gross income from X country. In accordance with such decree, the A Corporation paid X country the sum of $25,000 in 1943 with respect to its tax liability to the X country for the year 1942. Such amount, subject to the applicable limitations, is available as a credit to the A Corporation as foreign income, war-profits, or excess-profits taxes against the United States tax liability for the year 1942. "Foreign country" means any foreign state or political subdivision thereof, or any foreign political entity, which levies and collects income, war-profits, or excess-profits taxes. "Any possession of the United States" includes, among others, Puerto Rico, the Philippines, and the Virgin Islands. But see section 251. As to the meaning of "sources," see section 119. (See also section 3797.)

§ 29.131–3 *Conditions of allowance of credit.* If the taxpayer does not signify in his return his desire to claim credit for income, war-profits, or excess-profits taxes paid other than to the United States, but subsequent to the filing of such return chooses to claim such credit, the taxpayer must so notify the Commissioner and attach to such notification Form 1116 in the case of an individual, and Form 1118 in the case of a corporation. The form must be carefully filled in with all the information there called for and with the calculations of credits there indicated, and must be duly signed and sworn to or affirmed. Except where it is established to the satisfaction of the Commissioner that it is impossible for the taxpayer to furnish such evidence, the form must have attached to it (1) the receipt for each such tax payment if credit is sought for taxes already paid or (2) the return on which each such accrued tax was based if credit is sought for taxes accrued. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original, or a duly certified or authenticated copy. If the receipt or the return is in a foreign language, a certified translation thereof must be furnished by the taxpayer. Any additional information necessary for the determination under section 119 of the amount of income derived from sources without the United States and from each foreign country shall, upon the request of the Commissioner, be furnished by the taxpayer.

Where it has been established to the satisfaction of the Commissioner that it is impossible (1) to furnish a receipt for such foreign tax payment or (2) the foreign tax return, or (3) direct evidence of the amount of tax withheld at the source, secondary evidence of the payment or accrual of the tax or of the withholding of the tax may, in his discretion, and under such rules as he may prescribe, be accepted by the Commissioner.

In the case of a credit sought for a tax accrued but not paid, the Commissioner may require as a condition precedent to the allowance of credit a bond from the taxpayer in addition to Form 1116 or 1118. If such a bond is required, Form 1117 shall be used by an individual and Form 1119 by a corporation. It shall be in such sum as the Commissioner may prescribe, and shall be conditioned for the payment by the taxpayer of any amount of tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. This bond shall be executed by the taxpayer, or the agent or representative of the taxpayer, as principal, and by sureties satisfactory to and approved by the Commissioner. (See also section 1126 of the Revenue Act of 1926, as amended.)

For credit where taxes are paid by a foreign corporation controlled by a domestic corporation, see § 29.131–7. A claim for credit in such a case is also to be made on Form 1118. See § 29.131–6 with reference to the option granted by section 131 (d).

The taxpayer may, with respect to a particular taxable year, claim the benefits of section 131 at any time prior to the expiration of the period prescribed for the making of claim for credit or refund of the tax imposed under chapter 1 for such taxable year.

§ 29.131–4 *Redetermination of tax when credit proves incorrect.* In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount of the income tax of such tax-

payer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 322.

§ 29.131–5 *Countries which do or do not satisfy the similar credit requirement.* A country satisfies the similar credit requirement of section 131 (a) (3), as to income tax paid to such country, either by allowing to citizens of the United States residing in such country a credit for the amount of income taxes paid to the United States, or, in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such country. A country does not satisfy the similar credit requirement of section 131 (a) (3) if it does not allow any credit to citizens of the United States residing in such country for the amount of income taxes paid to the United States, or if such country does not impose any income taxes. If the country of which a resident alien is a citizen or subject does not allow to a United States citizen residing in such country a credit for taxes paid by such citizen to another foreign country, no credit is allowed to such resident alien for taxes paid by him to such other foreign country.

§ 29.131–6 *When credit for taxes may be taken.* The credit for taxes provided by section 131 (a) may ordinarily be taken either in the return for the year in which the taxes accrued or in which the taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Section 131 (d) allows the taxpayer, at his option and irrespective of the method of accounting employed in keeping his books, to take such credit for taxes as may be allowable in the return for the year in which the taxes accrued. An election thus made under section 131 (d) or under section 222 (c) or 238 (c) of the Revenue Act of 1924 or 1926, or under section 131 (d) of the Revenue Act of 1928, 1932, 1934, 1936, or 1938, must be followed in returns for all subsequent years, and no portion of any such taxes will be allowed as a deduction from gross income.

If, however, under the provisions of § 29.43–1 an amount otherwise constituting gross income for the taxable year from sources without the United States is, owing to monetary, exchange, or other restrictions imposed by a foreign country, not includible in gross income of the taxpayer for such year, the credit for income taxes imposed by such foreign country with respect to such amount shall be taken proportionately in any subsequent taxable year in which such amount or portion thereof is includible in gross income.

§ 29.131–7 *Taxes of subsidiary corporation*—(a) *Domestic corporation owning a majority of the stock of a foreign corporation.* In the case of a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year, the credit for foreign taxes includes not only the income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States by such domestic corporation, but also income, war-profits, and excess-profits taxes deemed to have been paid determined by taking the same proportion of any income, war-profits, and excess-profits taxes paid or accrued by such controlled foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. The amount of taxes deemed to have been paid is limited, however, to an amount which shall in no case exceed the same proportion of the tax against which the credit for foreign taxes is taken, which the amount of such dividends bears to the amount of the normal-tax net income of the domestic corporation in which such dividends are included. See, however, the limitations provided in section 131 (b) and § 29.131–8. If dividends are received from more than one controlled foreign corporation, the limitation is to be computed separately for the dividends received from each controlled foreign corporation. If the credit for foreign taxes includes taxes deemed to have been paid, the taxpayer must furnish the same information with respect to the taxes deemed to have been paid as it is required to furnish with respect to the taxes actually paid or accrued by it. Taxes paid or accrued by a controlled foreign corporation are deemed to have been paid by the domestic corporation for purposes of credit only.

(b) *Foreign subsidiary of foreign subsidiary of a domestic parent corporation.* In the case of any foreign corporation coming within the scope of section 131 (f) (1) and paragraph (a) of this section in which such foreign corporation (hereinafter referred to as the foreign parent) owns all of the stock, except qualifying shares, of another foreign corporation (hereinafter referred to as the foreign subsidiary), the foreign parent, receiving a dividend from the foreign subsidiary, shall be deemed to have paid that proportion of the income, war-profits, and excess-profits taxes actually paid by the foreign subsidiary upon or with respect to the accumulated profits of such foreign subsidiary which the amount of such dividends bears to the amount of such accumulated profits. Such tax is then taken into consideration in the determination of the amount of income, war-profits, and excess-profits taxes paid or deemed to have been paid by the foreign parent upon or with respect to its own accumulated profits from which dividends were paid by such foreign parent to its domestic parent corporation.

The application of these principles in the determination of the amount of the foreign tax available as a basis for a credit to the domestic parent corporation may be illustrated by the following example:

Example. The A Company, a domestic corporation, owns a majority of the voting stock of the B Company, Ltd., a foreign corporation, which in turn owns all of the stock except qualifying shares of the C Company, Ltd., another foreign corporation. The accumulated profits of the B Company amount to $200,000 (including $25,000 dividend derived from the C Company) and the foreign income tax paid by the B Company with respect to such accumulated profits amounts to $60,000. The C Company has accumulated profits of $150,000 upon or with respect to which the foreign income, war-profits, and excess-profits taxes are $45,000. A dividend of $50,000 is paid in 1942 by the B Company to the A Company and in the same year a dividend of $25,000 is paid by the C Company to the B Company. The amount of the foreign income, war-profits, and excess-profits tax of the C Company deemed to have been paid by the B Company is

$$\frac{25,000}{150,000} \times \$45,000, \text{ or } \$7,500.$$

The proportion of the foreign income tax deemed to have been paid by the A Company with respect to the accumulated profits of the B Company from which the dividend of $50,000 was paid by the B Company to the A Company equals

$$\frac{50,000}{200,000} \times (\$60,000 \text{ plus } \$7,500) \text{ equals } \$16,875.$$

§ 29.131–8 *Limitations on credit for foreign taxes.* The amount of the income and profits taxes paid or accrued (including the taxes which, in accordance with the provisions of section 131 (f), are deemed to have been paid) during the taxable year to each foreign country or possession of the United States, limited under section 131 (b) (1) so as not to exceed that proportion of the tax against which credit is taken which the taxpayer's net income from sources within such country or possession bears to (1) his entire net income, or (2) the sum of the normal-tax net income and the amount of the credit for adjusted excess profits net income provided in section 26 (e) in the case of a corporation, for the same taxable year, is the tentative credit in respect of the taxes paid or accrued to such country or possession. The sum of these tentative credits, limited under section 131 (b) (2) so as not to exceed the same proportion of the tax against which credit is taken which the taxpayer's net income from sources without the United States bears to (1) his entire net income, or (2) the normal-tax net income computed without the credit for adjusted excess profits net income provided in section 26 (e) in the case of a corporation, for the same taxable year, is the amount allowable as a credit against the income tax under chapter 1 for income or profits taxes paid or accrued to foreign countries or possessions of the United States. In computing the tax against which the credit is taken there must, for taxable years beginning before January 1, 1943, be excluded the tax, if any, imposed by

section 102, and for taxable years beginning after December 31, 1942, there must be excluded both the tax imposed by section 102 and the tax imposed by section 450.

The operation of the limitations on the credit for foreign taxes paid by individuals may be illustrated by the following examples:

Example (1). In 1942, A, a citizen of the United States, had a net income for services rendered within the United States amounting to $50,000 and a net income from sources within Great Britain of $25,000. He is entitled to a personal exemption of $500. The credit for foreign taxes allowable to A in his return for the calendar year 1942 is $14,788.67, computed as follows:

Income from sources within the United States		$50,000.00
Income from sources within Great Britain		25,000.00
Total net income		75,000.00
United States income tax on $75,000		44,366.00
British income and profits taxes		15,200.00
Limitation on British income and profits taxes under section 131 (b) (1) and (2) to determine credit $\left(\frac{25,000}{75,000}\text{ of }\$44,366\right)$		14,788.67
Credit for British income and profits taxes (total British income and profits taxes, reduced in accordance with the limitations under section 131 (b) (1) and (2))		14,788.67

Example (2). If, in example (1), above, A had a net income from sources within Great Britain of $15,000 and a net income from sources within Canada of $10,000 and the income and profits taxes paid or accrued to Great Britain and Canada were $8,950 and $4,500, respectively, the credit for foreign taxes allowable to A would be $13,373.20, computed as follows:

Income from sources within the United States		$50,000.00
Income from sources within Great Britain		15,000.00
Income from sources within Canada		10,000.00
Total net income		75,000.00
United States income tax on $75,000		44,366.00
British income and profits taxes		8,950.00
Limitation on British income and profits taxes under section 131 (b) (1) to determine tentative credit $\left(\frac{15,000}{75,000}\text{ of }\$44,366\right)$		8,873.20
Tentative credit for British income and profits taxes (total British income and profits taxes, reduced in accordance with the limitation under section 131 (b) (1))		8,873.20
Canadian income and profits taxes		4,500.00
Limitation on Canadian income and profits taxes under section 131 (b) (1) to determine tentative credit $\left(\frac{10,000}{75,000}\text{ of }\$44,366\right)$		5,915.47
Tentative credit for Canadian income and profits taxes (total Canadian income and profits taxes, since such amount is within the limitation under section 131 (b) (1))		4,500.00
Sum of tentative credits ($8,873.20 plus $4,500)		$13,373.20
Limitation on sum of tentatives credits under section 131 (b) (2) to determine credit $\left(\frac{25,000}{75,000}\text{ of }\$44,366\right)$		14,788.67
Total amount of credit allowable (sum of tentative credits, since such sum is within the limitation under section 131 (b) (2))		13,373.20

The operation of the limitations provided by section 131 (b) on the credit for foreign taxes paid by corporations may be illustrated by the following example:

Example. The net income for the calendar year 1942 and the income and profits taxes paid or accrued to foreign countries and possessions of the United States in the case of a domestic corporation were as follows:

Country	Net income	Loss	Income and profits taxes (paid or accrued)
United States	$200,000		
Great Britain	30,000		$17,000
Canada	20,000		5,600
Brazil	40,000		5,800
Argentine Republic	60,000		None
Mexico		$100,000	None
Puerto Rico	10,000		2,250
France (dividend)	50,000		[1] 9,000
France (branch)	20,000		6,000

[1] Withheld.

Net income		$330,000.00
Less:		
85 percent on dividends received from domestic corporations ($50,000)	$42,500.00	
Interest on obligations of the United States	25,000.00	
		67,500.00
Normal tax net income (before the credit for adjusted excess profits net income)		262,500.00
Less:		
Adjusted excess profits net income		105,000.00
Normal tax net income (after credit for adjusted excess profits net income)		157,500.00
Surtax net income ($330,000 minus ($42,500 plus $105,000))		182,500.00
Total foreign net income		130,000.00
United States tax (not including tax imposed under section 102)—		
Normal tax	$37,800.00	
Surtax	29,200.00	
		67,000.00

The income and losses from all foreign countries and possessions of the United States, except the dividend from sources within France, were derived from branch operations. Dividends of $50,000 were received from a French corporation, a majority of the voting stock of which was owned by the domestic corporation. The French corporation paid to France income and profits taxes on income earned by it and in addition a dividend tax for the account of its shareholders on income distributed to them, the latter tax being withheld and paid at the source.

The computation of the credit is as follows:

Great Britain

Income and profits tax paid or accrued	$17,000.00
Limitation under section 131 (b) (1) $\left(\frac{30,000}{262,500}\text{ of }\$67,000\right)$	7,657.14
Tentative credit	7,657.14

Canada

Income and profits tax paid or accrued	$5,600.00
Limitation under section 131 (b) (1) $\left(\frac{20,000}{262,500}\text{ of }\$67,000\right)$	5,104.76
Tentative credit	5,104.76

Brazil

Income and profits tax paid or accrued	$5,800.00
Limitation under section 131 (b) (1) $\left(\frac{40,000}{262,500}\text{ of }\$67,000\right)$	10,209.52
Tentative credit	5,800.00

Argentine Republic

Tentative credit	None.

Mexico

Tentative credit	None.

Puerto Rico

Income and profits tax paid or accrued	$2,250.00
Limitation under section 131 (b) (1) $\left(\frac{10,000}{262,500}\text{ of }\$67,000\right)$	2,552.38
Tentative credit	2,250.00

France

Dividend tax paid at source		$9,000.00
Income and profits taxes paid or accrued on branch operations		6,000.00
Income and profits taxes deemed under section 131 (f) to have been paid, computed, as follows:		
Dividend received on December 31 of the taxable year	$50,000.00	
Income of French corporation earned during taxable year	200,000.00	
Income and profits taxes paid to France on $200,000	30,000.00	
Accumulated profits ($200,000 minus $30,000)	170,000.00	
French taxes applicable to accumulated profits distributed $\left(\frac{50,000}{170,000}\right)$ of $\left(\frac{170,000}{200,000}\text{ of }\$30,000\right)$	7,500.00	
Limitation under section 131 (f) $\left(\frac{50,000}{262,500}\right.$ of $\left.\$67,000\right)$	12,761.90	
Income and profits taxes deemed to have been paid (French taxes applicable to accumulated profits distributed to domestic corporation, within the limitation of section 131 (f))		7,500.00
Total income and profits taxes paid or accrued and deemed to have been paid to France		22,500.00

Limitation under section 131 (b)	
(1) $\left(\frac{70,000}{262,500}$ of $67,000$\right)$	$17,866.66
Tentative credit	17,866.66
Sum of tentative credits	
Great Britain	$7,657.14
Canada	5,104.76
Brazil	5,800.00
Puerto Rico	2,250.00
France	17,866.66
	38,678.56
Limitation on sum of tentative credits under section 131 (b) (2) to determine credit $\left(\frac{130,000}{262,500}$ of $67,000$\right)$	33,180.94
Total amount of credit allowable (sum of tentative credits or the limitation under section 131 (b) (2), whichever is the lesser)	33,180.94

The deduction of excess profits tax imposed by subchapter E of chapter 2 is not allowed in the computation of net income for the purposes of chapter 1. However, in the determination of normal-tax net income, there is allowed as a credit against the adjusted net income the amount of income subject to the tax imposed by subchapter E of chapter 2 (see section 13 (a) (2). It is, therefore, provided in section 131 (b) that in the case of a domestic corporation the amount of the credit with respect to the tax paid or accrued to any country shall not exceed the same proportion of the tax imposed by chapter 1 which the corporation's net income from sources within such country bears to the entire normal-tax net income of such corporation computed without the allowance of the credit for adjusted excess profits net income. Hence, the total amount of the credit shall not exceed the same proportion of the tax imposed by chapter 1 which the corporation's net income from sources without the United States bears to the entire normal-tax net income computed without the allowance of the credit for adjusted excess profits net income. These principles may be illustrated by the following example:

Example. The following facts exist for the calendar year 1942 with respect to the A Corporation which makes its income tax returns on the calendar year basis:

Normal-tax net income (computed without the credit for adjusted excess profits net income)	$250,000
Less: Adjusted excess profits net income	75,000
Normal-tax net income (after credit for adjusted excess profits net income)	175,000
Net income from country A	100,000
Foreign tax paid on country A income	35,000
Total normal tax and surtax	70,000
Computation of foreign tax credit for purposes of normal tax and surtax	
$\frac{100,000}{250,000}$ (net income from A country) / (normal-tax net income before deducting adjusted excess profits net income) $\times \$70,000 = 28,000$	
Amount allowable as a credit	28,000

In the event that net income is derived from more than one foreign country or possession of the United States, the limitation provided in section 131 (b) (2) shall be applied based upon the taxpayer's net income from sources without the United States and the entire normal-tax net income of the corporation computed without the credit for adjusted excess profits net income.

§ 29.131-9 *Joint return by husband and wife.* In case of a husband and wife making a joint return, the credit for taxes paid or accrued to any foreign country or to any possession of the United States shall be computed upon the basis of the total taxes so paid by or accrued against the spouses, and the limitations prescribed by section 131 (b) upon such credit shall be applied with respect to the aggregate net income from sources within each such country or possession, the aggregate net income from all sources without the United States, and the aggregate net income from all sources, of the spouses.

RETURNS AND PAYMENT OF TAX

SEC. 141. CONSOLIDATED RETURNS [as amended by sec. 210 (b), Rev. Act 1939, repealing subsection (j); sec. 159 (a), Rev. Act 1942].

(a) *Privilege to file consolidated income and excess-profits-tax returns.* An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. In the case of a corporation which is not a member of the affiliated group after March 31, 1942, of the last taxable year of such group which begins before April 1, 1942, such corporation shall not be considered a member of the affiliated group for consolidated income-tax-return purposes for such year but shall be considered a member of such group for consolidated excess-profits-tax-return purposes for such year, and the consent required in the case of such corporation shall relate only to the consolidated excess-profits-tax regulations.

(b) *Regulations.* The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits-tax returns and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. Such regulations shall prescribe the amount of the net operating loss deduction of each member of the group which is attributable to a deduction allowed for a taxable year beginning in 1941 on account of property considered as destroyed or seized under section 127 (relating to war losses), and the allowance of the amount so prescribed as a deduction in computing the net income of the group shall not be limited by the amount of the net income of such member.

(c) *Computation and payment of tax.* In any case in which consolidated income-tax and excess-profits-tax returns are made or are required to be made, the taxes shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such returns; except that the tax imposed under section 15 or section 204 shall be increased by 2 per centum of the consolidated corporation surtax net income of the affiliated group of includible corporations. Only one specific exemption of $5,000 provided in section 710 (b) (1) shall be allowed for the entire affiliated group of corporations for the purposes of the tax imposed by Subchapter E of Chapter 2.

(d) *Definition of "affiliated group".* As used in this section, an "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(e) *Definition of "includible corporation".* As used in this section, the term "includible corporation" means any corporation except—

(1) Corporations exempt under section 101 from the tax imposed by this chapter.

(2) Insurance companies subject to taxation under section 201 or 207.

(3) Foreign corporations.

(4) Corporations entitled to the benefits of section 251, by reason of receiving a large percentage of their income from sources within possessions of the United States.

(5) Corporations organized under the China Trade Act, 1922.

(6) Regulated investment companies subject to tax under Supplement Q.

(f) *Includible insurance companies.* Despite the provisions of paragraph (2) of subsection (e), two or more domestic insurance companies each of which is subject to taxation under the same section of this chapter shall be considered as includible corporations for the purpose of the application of subsection (d) to such insurance companies alone.

(g) *Subsidiary formed to comply with foreign law.* In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this chapter and of Subchapter E of Chapter 2 as a domestic corporation.

(h) *Suspension of running of statute of limitations.* If a notice under section 272 (a) in respect of a deficiency for any taxable

year is mailed to a coporation, the suspension of the ruling of the statute of limitations, provided in section 277, shall apply in the case of corporations with which such corporation made a consolidated return for such taxable year.

(i) *Allocation of income and deductions.* For allocation of income and deductions of related trades or businesses, see section 45.

§ 29.141-1 *Consolidated income and excess profits tax returns of affiliated corporations*—(a) *In general.* Section 141 prescribes rules for the making of both consolidated income and excess profits tax returns by an affiliated group of corporations. Regulations promulgated as Parts 23 and 30 of this chapter are applicable, respectively, to the making of consolidated income and excess profits tax returns, and to the determination, computation, assessment, collection, and adjustment of income and excess profits tax liabilities of the affiliated group and each member thereof both during and after the period of affiliation.

(b) *Formation of and changes in affiliated group.* An affiliated group of corporations, within the meaning of section 141, is formed at the time that the common parent corporation, which is an includible corporation, becomes the owner directly of stock possessing at least 95 percent of the voting power of all classes of stock and at least 95 percent of each class of the nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) of another includible corporation. A corporation becomes a member of such an affiliated group at the time that one or more members of such group become the owners directly of stock possessing at least 95 percent of the voting power of all classes of its stock and at least 95 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends). A corporation ceases to be a member of such an affiliated group at the time that the members of such group cease to own directly stock possessing at least 95 percent of the voting power of all classes of its stock, or at least 95 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends).

(c) *Corporations to be included in consolidated returns.* The privilege of filing consolidated income and excess profits tax returns is extended to all includible corporations constituting an "affiliated group," as defined in section 141 (d). In case a corporation is a member of an affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for the part of the year during which it is a member of the group. However, a corporation which is not a member of such group after March 31, 1942, of the last taxable year of such group which begins before April 1, 1942, shall not be considered a member of such group for consolidated income tax return purposes for such year, but shall be considered a member of such group for consolidated excess profits tax return purposes for such year. An "includible corporation" is defined by section 141 (e) to mean any corporation except:

(1) A corporation exempt under section 101 from the tax imposed by chapter 1;

(2) An insurance company subject to taxation under section 201 or 207 (except as provided in section 141 (f));

(3) A foreign corporation (except as provided in section 141 (g));

(4) A corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its income from sources within possessions of the United States;

(5) A corporation organized under the China Trade Act, 1922; and

(6) A regulated investment company subject to tax under Supplement Q (sections 361 and 362).

The consolidated income tax return and the consolidated excess profits tax return must include every includible corporation which, under the provisions of section 141, is a member of the affiliated group. In no case may a consolidated return be filed by subsidiary corporations as an affiliated group unless the common parent corporation through which the subsidiaries are connected is a member of the group. For instance there will not be recognized as an affiliated group two domestic industrial corporations the common parent corporation of which is a regulated investment company subject to tax under Supplement Q. In addition, no corporation which is connected by stock ownership with an affiliated group of includible corporations through a nonincludible corporation may be included in the consolidated return of such group.

Every corporation which is a member of an affiliated group making consolidated returns under section 141 is a member of such group both for consolidated income tax and consolidated excess profits tax return purposes, regardless of any exemption to which it might have been entitled if separate returns had been made. See sections 725 (b) and 727.

(d) *Consolidated returns of insurance companies.* An insurance company subject to tax under section 204 is an includible corporation and may be included in an affiliated group together with corporations other than insurance companies taxable under section 201 or section 207. Insurance companies subject to tax under section 201 or 207 are not includible corporations under section 141 (e) (2). Under section 141 (f), however, a domestic insurance company taxable under section 201 may be included in an affiliated group comprised solely of other domestic insurance companies taxable under section 201; it may not be included in an affiliated group with other corporations. Similarly, a domestic insurance company taxable under section 207 may be included in an affiliated group comprised solely of other domestic insurance companies taxable under section 207; it may not be included in an affiliated group with other corporations. An affiliated group of domestic insurance companies taxable under section 201, or a group of domestic insurance companies taxable under section 207, may not include a domestic insurance company taxable under section 204.

(e) *Foreign corporations which may be treated as domestic corporations.* In the case of a domestic corporation owning or controlling, directly or indirectly, the entire capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of Canada or of Mexico and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated as a domestic corporation. The option to treat such foreign corporation as a domestic corporation must be exercised at the time of making the first consolidated income and excess profits tax returns for any taxable year beginning after December 31, 1941, and cannot be exercised at any time thereafter. If the election is exercised to treat such foreign corporation as a domestic corporation, it must be included in both the consolidated income and excess profits tax returns of the affiliated group of which it is a member for each year for which such group makes or is required to make a consolidated return.

(f) *Computation of tax.* The surtax imposed by section 15 or section 204 upon an affiliated group making a consolidated income tax return shall be increased by 2 percent of the consolidated corporation surtax net income. In case the consolidated corporation surtax net income exceeds $25,000, but not $50,000, the surtax on the first $25,000 is $3,000 instead of $2,500 as provided in section 15 (b) (2) in the case of corporations not making a consolidated return.

SEC. 142. FIDUCIARY RETURNS [as amended by sec. 7 (b), Rev. Act 1940; sec. 112 (b), Rev. Act. 1941; sec. 131 (c), Rev. Act 1942].

(a) *Requirement of return.* Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe—

(1) Every individual having a gross income for the taxable year of $500 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a gross income for the taxable year of $1,200 or over, if married and living with husband or wife;

(3) Every estate the gross income of which for the taxable year is $500 or over;

(4) Every trust the net income of which for the taxable year is $100 or over, or the gross income of which for the taxable year is $500 or over, regardless of the amount of the net income; and

(5) Every estate or trust of which any beneficiary is a nonresident alien.

(b) *Joint fiduciaries.* Under such regulations as the Commissioner with the approval of the Secretary may prescribe a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be sufficient compliance with the above require-

ment. Such fiduciary shall make oath (1) that he has sufficient knowledge of the affairs of the individual, estate, or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct.

(c) *Law applicable to fiduciaries.* Any fiduciary required to make a return under this chapter shall be subject to all the provisions of law which apply to individuals.

§ 29.142–1 *Fiduciary returns.* Every fiduciary, or at least one of joint fiduciaries, must make a return of income:

(a) *Returns for individuals.* For the individual whose income is in his charge, if the gross income of such individual is $500 or over, if single, or if married and not living with husband or wife for any part of the taxable year; or if such individual is married and was living with husband or wife for any part of the taxable year but not at the close of the taxable year and his gross income for the taxable year is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as head of a family); or if such individual is married and was living with husband or wife for the entire taxable year and the aggregate gross income of both husband and wife is $1,200 or over; or if such individual is married and was living with husband or wife at the close of the taxable year but not during the entire taxable year and the aggregate gross income of both husband and wife is $1,200 or over, or the aggregate gross income of both husband and wife is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as head of a family), or

(b) *Returns for estates and trusts.* For the estate for which he acts if the gross income of such estate is $500 or over, and for the trust for which he acts if the gross income of such trust is $500 or over, or if any beneficiary of such as computed under section 162, is $100 or over, or if any beneficiary, of such estate or trust is a nonresident alien. A return shall be filed for the taxable year of an estate which is a period of less than 12 months if the gross income of the estate for such taxable year is greater than the personal exemption allowable to a single person having a similar taxable year. See §§ 29.25–7 and 29.47–1. The requirements as to the filing of a return for a trust remain the same regardless of whether the taxable year of the trust is a period of less than 12 months.

The return in case (a) shall be on Form 1040 or 1040A. In case (b) a return is required on Form 1041. A copy of the will or trust instrument sworn to by the fiduciary as a true and complete copy in cases in which the gross income of the estate or trust is $5,000 or over, must be filed with the fiduciary return of the estate or trust, together with a statement by the fiduciary indicating the provisions of the will or trust instrument which, in his opinion, determine the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiaries, or the grantor, respectively. If, however, a copy of the will or trust instrument, or statement relating to the provisions of the will or trust instrument, has once been filed, it need not again be filed if the fiduciary return contains a statement showing when and where it was filed. If the trust instrument is amended in any way after such copy has been filed, a copy of the amendment, together with a statement by the fiduciary, indicating the effect, if any, in his opinion, of such amendment on the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiaries, or the grantor, respectively, must be filed with the return for the taxable year in which the amendment was made. See § 29.142–5 for returns in cases where any beneficiary is a nonresident alien. If the gross income of a decedent from the begining of the taxable year to the date of his death was equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as head of a family), the executor or administrator shall make a return for such decedent. (See § 29.25–7.)

For information returns required to be made by fiduciaries under section 147, see § 29.147–1.

As to further duties and liabilities of fiduciaries, see section 312.

§ 29.142–2 *Return by guardian or committee.* A fiduciary acting as the guardian of a minor, or as the guardian or committee of an insane person, having a gross income equal to, or in excess of, the credit allowed such person by section 25 (b) (1) and (3) (computed without regard to the status of the minor or insane person as head of a family) must make a return for such person on Form 1040 or 1040A and pay the tax, unless in the case of a minor the minor himself makes a return or causes it to be made. (See § 29.25–3.)

For the purpose of determining the liability of a fiduciary to render a return under the provisions of the preceding paragraph in cases where the minor or the incompetent is married and was living with husband or wife at the close of the taxable year, it is the aggregate gross income or the aggregate net income of both husband and wife which is controlling. (See § 29.51–1.)

§ 29.142–3 *Returns in case of two trusts.* In the case of two or more trusts the income of which is taxable to the beneficiaries, which were created by the same person and for which the same trustee acts, the trustee shall make a single return on Form 1041 for all such trusts, notwithstanding that they may arise from different instruments. If, however, one person acts as trustee for trusts created by different persons for the benefit of the same beneficiary, he shall make a return on Form 1041 for each trust separately.

§ 29.142–4 *Return by receiver.* A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on Form 1040 or 1040A. When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. (See section 52.) A receiver in charge of the business of a partnership shall render a return on Form 1065. A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business of an individual or corporation must make returns. (See also sections 147 and 148 (a).)

§ 29.142–5 *Return for nonresident alien beneficiary*—(a) *United States business.* If a citizen or resident fiduciary has the distribution of the income of an estate or trust any beneficiary of which is a nonresident alien engaged in trade or business within the United States at any time within the taxable year, the fiduciary shall make a return on Form 1040B for such nonresident alien and pay any tax shown thereon to be due. (See sections 143 and 211.) Unless such return is a true and accurate return of the nonresident alien beneficiary's income from all sources within the United States, the benefits of the credits and deductions to which the beneficiary is entitled cannot be obtained in the return filed by the fiduciary. (See sections 215 and 251.) If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing Form 1040B in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. If the sole beneficiary of an estate or trust is a nonresident alien engaged in trade or business within the United States at any time within the taxable year, the fiduciary shall make a return on Form 1041, as well as on Form 1040B. If there are two or more such nonresident alien beneficiaries, the fiduciary shall render a return on Form 1041 and also a return on Form 1040B for each nonresident alien beneficiary. (See further § 29.217–1.)

(b) *No United States business.* A citizen or resident fiduciary having the distribution of the income of an estate or trust will not be required to make a return for any beneficiary of the estate or trust who is a nonresident alien not engaged in trade or business within the United States at any time within the taxable year if the entire amount of the tax on the income payable to such beneficiary has been withheld at the source (see sections 143 and 211 (a)). A citizen or resident fiduciary having the distribution of the income of an estate or trust shall make a return on Form 1040NB–a if a beneficiary has gross income for the taxable year of more than $15,400 from the sources specified in section 211 (a), regardless of the amount of tax withheld at the source. If the gross

income from such sources is $15,400 or less, the return (if a return is required to be filed) for the beneficiary shall be on Form 1040NB. If a return is required to be filed for a beneficiary who is a resident of Canada, such return also shall be on Form 1040NB. If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing a return in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. The fiduciary shall make a return on Form 1042 of the tax on the entire amount of the income payable to the beneficiary. In addition to such return or returns, the fiduciary shall make a return on Form 1041 for the estate or trust, irrespective of the number of beneficiaries.

§ 29.142–6 *Time for filing return upon death, or termination of trust.* Under the provisions of section 47 (g), the return by a taxpayer which was not in existence throughout a taxable period of 12 months is a return for the fractional part of a year during which the taxpayer was in existence. If a return is required under the provisions of §§ 29.47–1 and 29.142–1 for the last taxable year of a decedent, the executor or administrator of the decedent shall file such return at the time prescribed in § 29.53–1. If a return for the last taxable year of an estate or trust is required to be filed under the provisions of § 29.142–1, such return shall be filed at the time prescribed in § 29.53–1, and the last date prescribed for such filing shall also be the due date for payment of the tax or the first installment thereof if payment is made under the provisions of section 56 (b).

The domiciliary representative is required to include in the return rendered by him as such domiciliary representative the entire income of the estate. Consequently the only return required to be filed by the ancillary representative is on Form 1041, which shall be filed with the collector for his district and shall show the name and address of the domiciliary representative, the amount of gross income received by the ancillary representative, and the deductions to be claimed against such income, including any amount of income properly paid or credited by the ancillary representative to any legatee, heir, or other beneficiary. If the ancillary representative for the estate of a nonresident alien is a citizen or resident of the United States, and the domiciliary representative is a nonresident alien, such ancillary representative is required to render the return otherwise required of the domiciliary representative.

SEC. 143. WITHHOLDING OF TAX AT SOURCE [as amended by secs. 5 (a), 202, Rev. Act 1940, secs. 107 (a) (b), 109 (a), Rev. Act 1941; secs. 108, 160 (a), Rev. Act 1942].

(a) *Tax-free covenant bonds*—(1) *Requirement of withholding.* In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation, issued before January 1, 1934, contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this chapter upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States: *Provided*, That if the liability assumed by the obligor does not exceed 2 per centum of the interest, then the deduction and withholding shall be at the following rates: (A) 30 per centum in the case of a nonresident alien individual (except that such rate shall be reduced, in the case of a resident of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, to such rate, not less than 5 per centum, as may be provided by treaty with such country), or of any partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens, (B) in the case of such a foreign corporation, 30 per centum, and (C) 2 per centum in the case of other individuals and partnerships: *Provided further*, That if the owners of such obligations are not known to the withholding agent the Commissioner may authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 30 per centum. [NOTE: For rate of 27½ percent prior to October 31, 1942, in lieu of 30 percent, see sec. 108 (a) (c), Rev. Act 1942, set forth below. See also sec. 160 (a), Rev. Act 1942, set forth below.]

(2) *Benefit of credits against net income.* Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in section 25 (b); nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 215.

(3) *Income of obligor and obligee.* The obligor shall not be allowed a deduction for the payment of the tax imposed by this chapter, or any other tax paid pursuant to the tax-free covenant clause, nor shall such tax be included in the gross income of the obligee.

(b) *Nonresident aliens.* All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (but only to the extent that any of the above items constitutes gross income from sources within the United States), or any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in subsection (a) of this section and except as otherwise provided in regulations prescribed by the Commissioner under section 215) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 30 per centum thereof, except that such rate shall be reduced, in the case of a nonresident alien individual a resident of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, to such rate (not less than 5 per centum) as may be provided by treaty with such country: *Provided*, That no such deduction or withholding shall be required in the case of dividends paid by a foreign corporation unless (1) such corporation is engaged in trade or business within the United States, and (2) more than 85 per centum of the gross income of such corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119: *Provided further*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent: *Provided further*, That the deduction and withholding in the case of interest on bonds, mortgages, or deeds of trust or other similar obligations of a corporation, within the provisions of subsection (a) (1) of this section were it not for the fact that the maturity date of such obligations has been extended on or after January 1, 1934, and the liability assumed by the debtor exceeds 27½ per centum of the interest, shall not exceed the rate of 27½ per centum per annum. Under regulations prescribed by the Commissioner, with the approval of the Secretary, there may be exempted from such deduction and withholding the compensation for personal services of nonresident alien individuals who enter and leave the United States at frequent intervals. [NOTE: For rate of 27½ percent prior to October 31, 1942, in lieu of 30 percent, see sec. 108 (a) (c), Rev. Act 1942, set forth below. See also sec. 160 (a), Rev. Act 1942, set forth below.]

(c) *Return and payment.* Every person required to deduct and withhold any tax under this section shall make return thereof on or before March 15 of each year and shall on or before June 15, in lieu of the time prescribed in section 56, pay the tax to the official of the United States Government authorized to receive it. Every such person is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this section.

(d) *Income of recipient.* Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

(e) *Tax paid by recipient.* If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

(f) *Refunds and credits.* Where there has been an overpayment of tax under this section any refund or credit made under the provisions of section 322 shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

(g) *Cross reference.* For definition of "withholding agent", see section 3797 (a) (16).

SEC. 108. WITHHOLDING OF TAX AT SOURCE. (Revenue Act of 1942, Title I.)

(a) Sections 143 (a) and (b) * * * are amended by striking out "27½ per centum"

wherever occurring therein and inserting in lieu thereof "30 per centum".

* * * * *

(c) Subsection (a) shall apply only with respect to the period beginning with the tenth day after the date of the enactment of this Act.

SEC. 109. TREATY OBLIGATIONS. (Revenue Act of 1942, Title I.)

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States.

SEC. 160. ALIENS AND FOREIGN CORPORATIONS TREATED AS NONRESIDENTS. (Revenue Act of 1942, Title I.)

(a) (1) Section 143 (a) (1) (relating to withholding of tax on interest from tax-free covenant bonds) is amended by striking out "and not having any office or place of business therein" wherever occurring therein.

(2) Section 143 (b) (relating to withholding of the tax at the source on nonresident aliens) is amended by striking out "and not having any office or place of business therein", by striking out "and not having an office or place of business therein", and by striking out "or has an office or place of business therein."

* * * * *

(4) The amendments made by this subsection shall apply only with respect to the period beginning with the tenth day after the date of the enactment of this Act.

* * * * *

§ 29.143–1 *Withholding tax at source*—(a) *Withholding in general.* Withholding of a tax of 30 percent (27½ percent prior to October 31, 1942) is required in the case of fixed or determinable annual or periodical income paid to a nonresident alien individual, even though such individual is engaged in trade or business within the United States (or, with respect to amounts paid prior to October 31, 1942, was engaged in trade or business or had an office or place of business therein) or to a nonresident partnership, composed in whole or in part of nonresident alien individuals, except (1) income from sources without the United States, including interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States (or, with respect to amounts paid prior to October 31, 1942, not engaged in trade or business and not having any office or place of business therein), (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934 (but see paragraph (b) of this section), (3) dividends paid by a foreign corporation unless (i) such corporation is engaged in trade or business within the United States (or, with respect to amounts paid prior to October 31, 1942, was engaged in trade or business or had an office or place of business therein), and (ii) more than 85 percent of the gross income of such corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States, as determined under the provisions of section 119, (4) dividends distributed by a corporation organized under the China Trade Act, 1922, to a resident of China, and (5) except that such rate of 30 percent (27½ percent prior to October 31, 1942) shall be reduced, in the case of a resident of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, to such rate, not less than 5 percent, as may be provided by treaty with such country. Under the regulations prescribed pursuant to the tax convention and protocol between the United States and Canada, signed March 4, 1942, effective generally January 1, 1941, the rate of tax to be withheld at the source has been reduced to 15 percent in the case of residents of Canada. Similarly, in accord with Article VII of the tax convention and protocol between the United States and Sweden, effective January 1, 1940, the rate of withholding shall, for a period of at least two years beginning with such date, be 10 percent with respect to dividends paid to residents of Sweden. Withholding is required in the case of interest paid on obligations issued by the United States or any agency or instrumentality thereof on or after March 1, 1941. (See §§ 29.22 (b) (4)–4 and 29.22 (b) (4)–6, relating to the taxation of such interest, and § 29.143–4, relating to ownership certificates.)

Under the provisions of section 143 (b) the rate of tax withheld at the source shall not exceed 27½ percent in the case of interest on bonds, mortgages, or deeds of trust or other similar obligations of a corporation within the provisions of section 143 (a) (1) were it not for the fact that the maturity date of such obligations has been extended on or after January 1, 1934.

The tax must be withheld at the source from the gross amount of any distribution made by a corporation, other than a nontaxable distribution payable in stock or stock rights or a distribution in partial or complete liquidation, without regard to any claim that all or a portion of such distribution is not taxable. Appropriate adjustments, if any, will be made upon the filing of claims for refund.

The tax need not be withheld on accrued interest paid in connection with the sale of bonds between interest dates.

A tax of 30 percent (27½ percent prior to October 31, 1942) must be withheld from interest on bonds or securities not containing a tax-free covenant, or containing a tax-free covenant and issued on or after January 1, 1934, if the owner is unknown to the withholding agent, except where such interest represents income from sources without the United States.

For withholding in the case of income paid to nonresident foreign corporations, see § 29.144–1.

Resident or domestic fiduciaries are required to deduct the income tax at the source from all fixed or determinable annual or periodical gains, profits, and income of nonresident alien beneficiaries, to the extent that such items constitute gross income from sources within the United States. Bond interest, dividends, or other fixed or determinable annual or periodical income paid to a nonresident alien fiduciary is subject to withholding even though the beneficiaries of the estate or trust are citizens or residents of the United States.

The income of a trust created by a nonresident alien individual and taxable to the grantor under the provisions of section 166 or 167 is subject to withholding even though the beneficiaries of such trust are citizens or residents of the United States, and regardless of whether the beneficiaries are exempt from income tax.

A debtor corporation having an issue of bonds or other similar obligations which appoints a duly authorized agent to act in its behalf under the withholding provisions of the Internal Revenue Code, is required to file notice of such appointment with the Commissioner of Internal Revenue, Withholding Returns Section, Washington, D. C., giving the name and address of the agent.

If, in connection with the sale of its property, payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, or corporation, must deduct and withhold such taxes as would be required to be withheld by the assignor had not such sale or transfer been made.

For determining income from sources within the United States, see section 119.

As to who are nonresident alien individuals, see §§ 29.211–2 and 29.3797–8. For classification of foreign corporations, see §§ 29.231–2 and 29.3797–8. As to what partnerships are deemed to be nonresident partnerships, see § 29.3797–8.

For withholding in the case of dividends distributed by a corporation organized under the China Trade Act, 1922, see §§ 29.143–3 and 29.262–4.

(b) *Tax-free covenant bonds issued before January 1, 1934.* The withholding provisions of section 143 (a) (1) are applicable only to bonds, mortgages, or deeds of trust, or other similar obligations of a corporation which were issued before January 1, 1934, and which contain a tax-free covenant. For the purpose of section 143 (a) (1) bonds, mortgages, or deeds of trust, or other similar obligations of a corporation, are issued when delivered. If a broker or other person acts as selling agent of the obligor the obligation is issued when delivered by the agent to the purchaser. If a broker or other person purchases the obligation outright for the purpose of holding or reselling it, the obligation is issued when delivered to such broker or other person.

In order that the date of issue of bonds, mortgages, or deeds of trust, or other similar obligations of corporations containing a tax-free covenant may be readily determined by the owner, for the purpose of perparing the ownership certificates required under §§ 29.143–1 to 29.143–9, inclusive, the "issuing" or debtor corporation shall indicate, by an appropriate notation, the date of issue or use the phrase, "Issued on or after January 1, 1934," on each such obligation or in a statement accompanying the delivery of such obligation.

In cases where on or after January 1, 1934, the maturity date of bonds or other obligations of a corporation is extended, the bonds or other obligations shall be considered to have been issued

on or after January 1, 1934. The interest on such obligations is not subject to the withholding provisions of section 143 (a) but falls within the class of interest described in section 143 (b).

In the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, paid to an individual, a fiduciary, or a partnership, whether resident or nonresident, withholding of a tax of 2 percent is required, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 percent of the interest, withholding is required at the rate of 30 percent (27½ percent prior to October 31, 1942) in the case of a nonresident alien, or a nonresident partnership composed in whole or in part of nonresident alien individuals, or if the owner is unknown to the withholding agent. The rates of withholding applicable to the interest on bonds or other obligations of a corporation containing a tax-free covenant, and issued before January 1, 1934, are applicable to interest on such obligations issued by a domestic corporation or a resident foreign corporation. However, withholding is not required in the case of interest payments on such bonds or obligations if such interest is not to be treated as income from sources within the United States under section 119 (a) (1) (B) and the payments are made to a nonresident alien or a partnership composed wholly of nonresident aliens. A nonresident foreign corporation having a fiscal or paying agent in the United States is required to withhold a tax of 2 percent upon the interest on its tax-free covenant bonds issued before January 1, 1934, paid to an individual or fiduciary who is a citizen or resident of the United States, or to a partnership any member of which is a citizen or resident, or to an unknown owner.

For withholding in the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, paid to nonresident foreign corporations, see § 29.144–1.

Bonds issued under a trust deed containing a tax-free covenant are treated as if they contain such a covenant. If neither the bonds nor the trust deeds given by the obligor to secure them contained a tax-free covenant, but the original trust deeds were modified prior to January 1, 1934, by supplemental agreements containing a tax-free covenant executed by the obligor corporation and the trustee, the bonds issued prior to January 1, 1934, are subject to the provisions of section 143 (a), provided appropriate authority existed for the modification of the trust deeds in this manner. The authority must have been contained in the original trust deeds or actually secured from the bondholders.

In the case of corporate bonds or other obligations containing a tax-free covenant, issued before January 1, 1934, the corporation paying a Federal tax, or any part of it, for someone else pursuant to its agreement is not entitled to deduct such payment from its gross income on any ground nor shall the tax so paid be included in the gross income of the bondholder. The amount of the tax may nevertheless be claimed by the bondholder as a credit against the total amount of income tax due in accordance with section 143 (d). The tax withheld at the source upon tax-free covenant bond interest included in the income of an estate or trust and taxable to the beneficiaries thereof (including the grantor of a trust subject to section 166 or 167) is allowable, pro rata, as a credit against (1) the tax required to be withheld by the fiduciary from the income of nonresident alien beneficiaries and (2) the total tax computed in the returns of the beneficiaries required to make returns. In the case, however, of corporate bonds or other obligations containing an appropriate tax-free covenant, the corporation paying for someone else, pursuant to its agreement, a State tax or any tax other than a Federal tax may deduct such payment as interest paid on indebtedness.

§ 29.143–2 *Fixed or determinable annual or periodical income.* Only fixed or determinable annual or periodical income is subject to withholding. The Internal Revenue Code specifically includes in such income, interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. But other kinds of income are included, as, for instance, royalties.

Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually if it is paid periodically; that is to say from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with someone's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on sales which is paid or credited monthly receives determinable periodical income. The share of the fixed or determinable annual or periodical income of an estate or trust from sources within the United States which is distributable, whether distributed or not, or which has been paid or credited during the taxable year to a nonresident alien beneficiary of such estate or trust constitutes fixed or determinable annual or periodical income within the meaning of section 143 (b). The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income. Such items as taxes, interest on mortgages, or premiums on insurance paid to or for the account of a nonresident alien landlord by a tenant, pursuant to the terms of the lease, constitute fixed or determinable annual or periodical income.

§ 29.143–3 *Exemption from withholding.* Withholding from interest on bonds or other obligations of corporations issued prior to January 1, 1934, containing a tax-free covenant shall not be required in the case of a citizen or resident if he files with the withholding agent when presenting interest coupons for payment, or not later than February 1 of the following year, an ownership certificate on Form 1000 stating that his net income does not exceed his personal exemption and credit for dependents and (in the case of taxable years beginning after December 31, 1942) that his victory tax net income does not exceed the specific exemption of $624. To avoid inconvenience a resident alien should file a certificate of residence on Form 1078 with withholding agents, who shall forward such certificates to the Commissioner of Internal Revenue, Withholding Returns Section, Washington, D. C., with a letter of transmittal.

The income of domestic corporations and of resident foreign corporations is free from withholding.

No withholding from dividends paid by a corporation organized under the China Trade Act, 1922, is required unless the dividends are treated as income from sources within the United States under section 119 and are distributed to:

(a) A nonresident alien other than a resident of China at the time of such distribution;

(b) A nonresident partnership composed in whole or in part of nonresident aliens (other than a partnership resident in China); or

(c) A nonresident foreign corporation (other than a corporation resident in China).

The salary or other compensation for personal services of a nonresident alien individual who enters and leaves the United States at frequent intervals, shall not be subject to deduction and withholding of income tax at the source, provided he is a resident of Canada or Mexico.

Payments made by the United States or other public or private agencies or employers to nonresident aliens brought into the United States for the purpose of the production and harvesting of agricultural commodities pursuant to Public Law 45 (78th Congress), approved April 29, 1943, shall not be subject to deduction and witholding of income tax at the source (see section 5 (b) of such Public Law 45).

The following items of fixed or determinable annual or periodical income from sources within the United States received by a citizen of France residing in France, or a corporation organized under the laws of France, are not subject to the withholding provisions of the Internal Revenue Code, since such income is exempt from Federal income tax under the provisions of the tax convention between the United States and France, signed April 27, 1932, and effective January 1, 1936:

(1) Amounts paid as consideration for the right to use patents, secret processes and formulas, trade-marks, and other analogous rights;

(2) Income received as copyright royalties; and

(3) Private pensions and life annuities.

The person paying such income should be notified by letter from the French citizen or corporation, as the case may be, that the income is exempt from taxation under the provisions of the convention and protocol referred to above. Such letter from a citizen of France shall contain his address and a statement that he is a citizen of France residing in France. The letter from such corporation shall contain the address of its office or place of business and a statement that it is a corporation organized under the laws of the Republic of France, and shall be signed by an officer of the corporation giving his official title. The letter of notification or a copy thereof should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Withholding Returns Section, Washington, D. C.

As to items of income received on or after January 1, 1940, by individual residents of Sweden or by Swedish corporations or other Swedish entities and not subject to the withholding provisions of the Internal Revenue Code, see the tax convention between the United States and Sweden, effective January 1, 1940, and the regulations thereunder.

As to items received on or after January 1, 1941, by individual residents of Canada and not subject to the withholding provisions of the Internal Revenue Code, see the tax convention and protocol between the United States and Canada, effective January 1, 1941, and the regulations thereunder.

A nonresident alien individual not engaged in trade or business within the United States at any time within the taxable year is subject to the tax imposed by section 211 (a) on gross income and is not entitled to any personal exemption or credit for dependents. Although a nonresident alien individual who is engaged in trade or business within the United States is entitled to the personal exemption of $500 (and a credit for dependents if he is a resident of Canada or Mexico), he is subject to the normal tax and the surtax imposed by sections 11 and 12 by reason of the provisions of section 211 (b) and to the victory tax imposed by section 450; and, in the case of such an individual, the benefit of the personal exemption and credit for dependents may not be received by filing a claim therefor with the withholding agent. However, in the determination of the tax to be withheld at the source under section 143 (b) with respect to remuneration paid on or after July 1, 1943, for labor or personal services performed within the United States by a nonresident alien, the benefit of the personal exemption of $500 shall be allowed, prorated upon the basis of $1.40 per day for the period of employment during any portion of which labor or personal services are performed within the United States by such alien. Thus if A, a nonresident alien seaman employed by the X Shipping Corporation, is paid upon the termination of the voyage and such voyage covers 100 days, and A performed personal services within the United States during, or incident to, such voyage, the amount of $140 will be allocated as the portion of the personal exemption to be allowed as a credit against the remuneration of A for personal services performed within the United States during such voyage and withholding shall be applied against the balance, if any, of such remuneration. If, for example, the total remuneration paid to A for such voyage is $800, of which the sum of $120 is allocable to sources within the United States, there is no withholding. As to what constitutes remuneration for labor or personal services rendered within the United States, see section 119 (a) (3) and § 29.119–4. The amount of the compensation allocable to labor or personal services performed within the United States together with the amount of the personal exemption, prorated as set forth in this paragraph, shall be shown on the annual withholding return, Form 1042.

Under the provisions of the tax convention between the United States and Canada (ratifications exchanged June 15, 1942), annuities and pensions received by individual residents of Canada are exempt from tax and are exempt from withholding with respect to payments of such items made on or after June 27, 1942.

§ 29.143–4 *Ownership certificates for bond interest.* In accordance with the provisions of section 147 (b), citizens and resident individuals and fiduciaries, resident partnerships and nonresident partnerships all of the members of which are citizens or residents, owning bonds, mortgages, or deeds of trust, or other similar obligations issued by a domestic corporation, a resident foreign corporation, or a nonresident foreign corporation having a fiscal agent or a paying agent in the United States, when presenting interest coupons for payment shall file ownership certificates for each issue of such obligations regardless of the amount of the coupons. However, in the case of interest coupons presented on or after January 1, 1943, such ownership certificates are required to be filed by such citizens, residents, fiduciaries, and partnerships only with respect to interest coupons on bonds, mortgages, or deeds of trust, or other similar obligations issued prior to January 1, 1934, and containing a tax-free covenant. In the case of interest on obligations of the United States or any agency or instrumentality thereof, regardless of the date of issuance thereof, ownership certificates shall be filed by such citizens, residents, fiduciaries, and partnerships only in the case of interest paid prior to January 1, 1943.

In the case of interest payments on overdue coupon bonds, the interest coupons of which have been exhausted ownership certificates are required to be filed when collecting the interest in the same manner as if interest coupons were presented for collection.

In all cases where the owner of bonds, mortgages, or deeds of trust, or other similar obligations of a corporation is a nonresident alien, a nonresident partnership composed in whole or in part of nonresident aliens, a nonresident foreign corporation, or where the owner is unknown, an ownership certificate for each issue of such obligations shall be filed when interest coupons for any amount are presented for payment. The ownership certificate is required in such cases whether or not the obligation contains a tax-free covenant. However, ownership certificates need not be filed by a nonresident alien, a partnership composed wholly of nonresident aliens, or a nonresident foreign corporation in connection with interest payments on such bonds, mortgages, or deeds of trust, or other similar obligations of a domestic or resident foreign corporation qualifying under section 119 (a) (1) (B), or of a nonresident foreign corporation. Ownership certificates (Form 1001) shall also be filed in the case of interest paid on or after January 1, 1942, on obligations of the United States or any agency or instrumentality thereof, regardless of the date of issuance of such obligations, if such obligations are owned by the persons described in the first sentence of this paragraph.

The ownership certificate shall show the name and address of the obligor, the name and address of the owner of the obligations, a description of the obligations, the amount of interest and its due date, the rate at which tax is to be withheld, and the date upon which the interest coupons were presented for payment.

Ownership certificates need not be filed in the case of interest payments on obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or the obligations of possessions of the United States. (See section 22 (b) (4).) Ownership certificates are not required to be filed in connection with interest payments on bonds, mortgages, or deeds of trust, or other similar obligations issued by an individual or a partnership. Ownership certificates are not required where the owner is a domestic corporation, a resident foreign corporation, or a foreign government.

When interest coupons detached from corporate bonds, or (as to coupons presented on or after January 1, 1942) from obligations of the United States or of any agency or instrumentality thereof, are received unaccompanied by ownership certificates, unless the owner of the bonds is known to the first bank to which the coupons are presented for payment, and the bank is satisfied that the owner is a person who is not required to file an ownership certificate, the bank shall require of the payee a statement showing the name and address of the person from whom the coupons were received by the payee, and alleging that the owner of the bonds is unknown to the payee. Such statement shall be forwarded to the Commissioner with the monthly (quarterly, for the calendar year 1943 and subsequent calendar years) return on Form 1012. The bank shall also require the payee to prepare a certificate on Form 1001, crossing out "owner" and inserting "payee" and entering the amount of the

interest, and shall stamp or write across the face of the certificate "Statement furnished," adding the name of the bank.

Ownership certificates are required in connection with interest payments on registered bonds as in the case of coupon bonds, except that if ownership certificates are not furnished by the owner of such bonds, ownership certificates must be prepared by the withholding agent.

§ 29.143-5 *Form of certificate for citizens or residents.* For the purpose of § 29.143-4, Form 1000 shall be used in preparing ownership certificates of citizens or residents of the United States (individual or fiduciary), resident partnerships, and nonresident partnerships all of the members of which are citizen or residents. If the obligations are issued by a nonresident foreign corporation having a fiscal or paying agent in the United States, Form 1000 should be modified to show the name and address of the fiscal agent or the paying agent in addition to the name and address of the debtor corporation.

§ 29.143-6 *Form of certificate for nonresident aliens, nonresident foreign corporations, and unknown owners.* For the purpose of § 29.143-4, Form 1001 shall be used in preparing ownership certificates (a) of nonresident aliens, (b) of nonresident partnerships composed in whole or in part of nonresident aliens, (c) of nonresident foreign corporations, and (d) where the owner is unknown.

§ 29.143-7 *Return and payment of tax withheld.* Every withholding agent shall make on or before March 15 an annual return on Form 1013 of the tax withheld from interest on bonds or other obligations of corporations and interest on obligations issued by the United States or any agency or instrumentality thereof on or after March 1, 1941. This return should be filed with the collector for the district in which the withholding agent is located. The withholding agent shall also make a monthly return on Form 1012 on or before the 20th day of the month following that for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the monthly return. Such of the forms as report interest from which the tax is to be withheld should be listed on the monthly return. While the forms reporting interest from which no tax is to be withheld need not be listed on the return, the number of such forms submitted should be entered in the space provided. However, for the calendar year 1943 and subsequent calendar years the withholding agent shall make a quarterly return on Form 1012 on or before the last day of the month following the termination of the quarter for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the quarterly return. Forms 1001 should be listed on the quarterly return. While Forms 1000 need not be listed on the return, the number of such forms submitted and the total amount of interest paid and of the tax withheld on such of the forms as report interest from which the tax is to be withheld should be entered in the spaces provided. If Form 1000 is modified to show the name and address of a fiscal or paying agent in the United States (see § 29.143-5), Forms 1012 and 1013 should be likewise modified. In the case of interest on obligations of the United States or of any agency or instrumentality thereof the withholding agents shall be: (1) The Commissioner of the Public Debt for interest paid by checks issued through the Bureau of the Public Debt; (2) the Treasurer of the United States for all interest paid by him, whether by check or otherwise; and (3) each Federal reserve bank for all interest paid by it, whether by check or otherwise.

Every person required to deduct and withhold any tax from income other than such bond interest shall make an annual return thereof to the collector on or before March 15 on Form 1042, showing the amount of tax required to be withheld from each nonresident alien, nonresident partnership composed in whole or in part of nonresident aliens, or nonresident foreign corporation to which income other than bond interest was paid during the previous taxable year. Form 1042 should be filed with the collector for the district in which the withholding agent is located. Every United States withholding agent shall make and file with the collector, in duplicate, an information return on Form 1042B, in addition to the withholding return on Form 1042, with respect to the items of income from which a tax of only 15 percent was withheld from persons whose addresses are in Canada (5 percent in the case of dividends falling within the scope of paragraph 2 of Article XI of the convention). There shall be reported on Form 1042B not only such items of income listed on Form 1042, but also such items of interest listed on monthly returns (quarterly, for the calendar year 1943 and subsequent calendar years) on Form 1012, including items of interest where the liability for withholding is only 2 percent.

In every case the tax withheld must be paid to the collector on or before June 15 of the following year. For penalties and additions to the tax attaching upon failure to make such returns or such payments, see sections 145 and 291.

If a debtor corporation has designated a person to act for it as withholding agent, and such person has not withheld any tax from the income nor received any funds from the debtor corporation to pay the tax which the debtor corporation assumed in connection with its tax-free covenant bonds, such person cannot be held liable for the tax assumed by the debtor corporation merely by reason of such person's appointment as withholding agent. If a duly authorized withholding agent has become insolvent or for any other reason fails to make payment to the collector of internal revenue of money deposited with it by the debtor corporation to pay taxes, or money withheld from bondholders, the debtor corporation is not discharged of its liability under section 143 (a) (1), since the withholding agent is merely the agent of the debtor corporation.

In any case where income is payable in any medium other than money, the withholding agent shall not release the property so received until it has been placed in funds sufficient to enable it to pay over in money the tax required to be withheld with respect to such income.

§ 29.143-8 *Ownership certificates in the case of fiduciaries and joint owners.* If fiduciaries have the control and custody of more than one estate or trust, and such estates and trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each estate or trust, regardless of the fact that the bonds are of the same issue. The ownership certificate should show the name of the estate or trust, in addition to the name and address of the fiduciary. If bonds are owned jointly by two or more persons, a separate ownership certificate must be executed in behalf of each of the owners.

§ 29.143-9 *Return of income from which tax was withheld.* The entire amount of the income from which the tax was withheld shall be included in gross income in the return required to be made by the recipient of the income without deduction for such payment of the tax but any tax so withheld shall be credited against the total income tax as computed in the taxpayer's return. (See, however, § 29.142-5.) If the tax is paid by the recipient of the income or by the withholding agent it shall not be recollected from the other, regardless of the original liability therefor, and in such event no penalty will be asserted against either person for failure to return or pay the tax where no fraud or purpose to evade payment is involved.

Tax withheld at the source upon fixed or determinable annual or periodical income paid to nonresident alien fiduciaries is deemed to have been paid by the persons ultimately liable for the tax upon such income. Accordingly, if a person is subject to the taxes imposed by section 11, 12, 13, 14, or 15 (and, for a taxable year beginning after December 31, 1942, the victory tax imposed by section 450), upon any portion of the income of a nonresident alien estate or trust, the part of any tax withheld at the source which is properly allocable to the income so taxed to such person shall be credited against the amount of the income tax computed upon his return, and any excess shall be credited against any income, war-profits, or excess-profits tax, or installment thereof, then due from such person, and any balance shall be refunded.

SEC. 144. PAYMENT OF CORPORATION INCOME TAX AT SOURCE [as amended by sec. 5 (b), Rev. Act 1940; secs. 107 (a), 109 (a), Rev. Act 1941; secs. 108 (a), 160 (a), Rev. Act 1942].

In the case of foreign corporations subject to taxation under this chapter not engaged in trade or business within the United States, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in sec-

tion 143 a tax equal to 30 per centum thereof, except that in the case of corporations organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, such rate with respect to dividends shall be reduced to such rate (not less than 5 per centum) as may be provided by treaty with such country; and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subsection (a) of that section (relating to tax-free covenant bonds) the deduction and withholding shall be at the rate specified in such subsection. [NOTE: For rate of 27½ percent prior to October 31, 1942, in lieu of 30 percent, see sec. 108 (a) (c), Rev. Act 1942, set forth below. See also sec. 160 (a), Rev. Act 1942, set forth below.].

SEC. 108. WITHHOLDING OF TAX AT SOURCE. (Revenue Act of 1942, Title I.)

(a) Sections * * * and 144 are amended by striking out "27½ per centum" wherever occurring therein and inserting in lieu thereof "30 per centum".

* * * * *

(c) Subsection (a) shall apply only with respect to the period beginning with the tenth day after the date of the enactment of this Act.

SEC. 109. TREATY OBLIGATIONS. (Revenue Act of 1942, Title I.)

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States.

SEC. 160. ALIENS AND FOREIGN CORPORATIONS TREATED AS NONRESIDENTS. (Revenue Act of 1942, Title I.)

(a) * * *

(3) Section 144 (relating to payment of corporation income tax at source) is amended by striking out "and not having any office or place of business therein".

(4) The amendments made by this subsection shall apply only with respect to the period beginning with the tenth day after the date of the enactment of this Act.

* * * * *

§ 29.144–1 *Withholding in the case of nonresident foreign corporations.* A tax of 30 percent (27½ percent prior to October 31, 1942) is required to be withheld in the case of fixed or determinable annual or periodical income paid to a nonresident foreign corporation except (1) income from sources without the United States, including interest on deposits with persons carrying on the banking business paid to such corporation, and (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, where the liability assumed by the obligor exceeds 2 percent of the interest. However, in accord with Article VII of the tax convention and protocol between the United States and Sweden, effective January 1, 1940, the rate of withholding shall, for a period of at least two years beginning with such date, be 10 percent with respect to dividends paid to a corporation or other entity created or organized under the laws of Sweden. Under the regulations prescribed pursuant to the tax convention and protocol between the United States and Canada, signed March 4, 1942, and effective generally January 1, 1941, the tax to be withheld at the source has been reduced to 15 percent in the case of corporations organized under the laws of Canada.

Withholding is required in the case of interest paid on obligations issued by the United States or any agency or instrumentality thereof on or after March 1, 1941. (See §§ 29.22 (b) (4)–4 and 29.22 (b) (4)–6, relating to the taxation of such interest, and § 29.143–4, relating to ownership certificates.)

Withholding of a tax at the rate of 2 percent is required in the case of interest paid to a nonresident foreign corporation, upon bonds or other obligations of a corporation issued prior to January 1, 1934, and containing a tax-free covenant, if the liability assumed by the obligor exceeds 2 percent of the interest and the interest is treated as income from sources within the United States.

A tax of 30 percent (27½ percent prior to October 31, 1942) is required to be withheld from dividends (other than dividends distributed by a corporation organized under the China Trade Act, 1922, to a resident of China) from sources within the United States paid to a nonresident foreign corporation, except that such rate of 30 percent (27½ percent prior to October 31, 1942) shall be reduced, in the case of corporations organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, to such rate (not less than 5 percent) as may be provided by treaty with such country. Under the regulations prescribed pursuant to the tax convention between the United States and Canada (ratifications exchanged June 15, 1942) the rate of tax to be withheld at the source has been reduced to 15 percent effective June 27, 1942, in the case of nonresident corporations organized under the laws of Canada. Dividends paid to such corporations and conforming to the provisions of paragraph 2 of Article XI of such convention are after such effective date subject to withholding at the reduced rate of 5 percent. See §§ 7.10 to 7.17, inclusive, of this chapter,[1] approved June 27, 1942. Dividends paid by a foreign corporation are not, however, subject to withholding unless such corporation is engaged in trade or business within the United States (or, in the case of dividends paid before October 31, 1942, if such corporation was engaged in trade or business within the United States or had an office or place of business therein) and more than 85 percent of the gross income of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119. (See also section 143.)

For withholding in the case of dividends distributed by a corporation organized under the China Trade Act, 1922, see §§ 29.143–3 and 29.262–4.

Under the provisions of section 143 (b), as amended by section 108 of the Revenue Act of 1942, the rate of tax withheld at the source shall not exceed 27½ percent in the case of interest on bonds, mortgages, or deeds of trust or other similar obligations of a corporation within the provisions of section 143 (a) (1) were it not for the fact that the maturity date of such obligations has been extended on or after January 1, 1934.

§ 29.144–2 *Aids to withholding agents in determining liability for withholding of tax.* Since no withholding of tax on bond interest, dividends, or other income is required in the case of a resident foreign corporation (see § 29.143–3), the person paying such income should be notified by a letter from such corporation that it is not subject to the withholding provisions of the Internal Revenue Code. The letter from the corporation shall contain the address of its office or place of business in the United States and be signed by an officer of the corporation giving his official title. Such letter of notification, or copy thereof, should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Withholding Returns Section, Washington, D. C. The same procedure should be followed in the case of resident partnerships, composed in whole or in part of nonresident aliens, not subject to the withholding provisions of the Code except in the case of interest on tax-free covenant bonds. The letter should be signed by a member of the firm.

When a payor corporation, or any other person (including a nominee), having the control, receipt, custody, disposal, or payment of dividends has no definite knowledge of the status of a shareholder, the tax should be withheld if the shareholder's address is outside the United States. If the shareholder's address is within the United States, it may be assumed that such shareholder is a citizen or a resident thereof. Unless the name and style of the shareholder are such as to indicate clearly that he is a nonresident alien, an address in care of another person in the United States does not of itself warrant the treating of the shareholder as a nonresident alien. If a shareholder changes his address from a place without the United States to a place within the United States, the tax should be withheld unless proof is furnished showing that he is a citizen or a resident of the United States. A person's written statement that he is a citizen, or resident of the United States, may be relied upon by the payor of income as proof that such person is a citizen or resident of the United States.

The following tables of withholding rates under the Internal Revenue Code, as modified by tax conventions between the United States and other countries, have been prepared for the purpose of making a summary of such rates readily available to withholding agents:

[1] 7 F.R. 4825.

I. FOR THE PERIOD PRIOR TO OCTOBER 31, 1942

Classes of taxpayers	Corporate bond interest			Salary or other compensation for personal services	Other fixed or determinable annual or periodical income, including dividends, from sources within the United States
	With tax-free covenant and issued before Jan. 1, 1934		Without tax-free covenant or issued on or after Jan. 1, 1934, with tax-free covenant		
	If corporation assumes over 2 percent of the tax	If corporation assumes not over 2 percent of the tax			
1. Citizen or resident individual, fiduciary, or partnership	Percent 2	Percent 2	Percent	Percent	Percent
2. Nonresident individual, fiduciary, or partnership	2	27½	27½	[1] 27½	[2] 27½
3. Domestic corporation or resident foreign corporation					
4. Nonresident foreign corporation	2	27½	27½	27½	[3] [4] 27½
5. Individual, fiduciary, or partnership, resident of of Canada, and corporation organized under laws of Canada	2	15	15	15	[4] 15
6. Unknown owner	2	27½	27½		

[1] Salary or compensation for personal services rendered in the United States is not subject to withholding in the case of nonresident aliens, residents of Canada or Mexico, who enter and leave the United States at frequent intervals.
[2] In the case of a resident of Sweden or a corporation or other entity organized under the laws of Sweden the rate with respect to dividends is 10 percent for at least two years beginning January 1, 1940 (see part 25 of this chapter).
[3] Interest on any noncorporate security the owner of which is unknown to the withholding agent is subject to withholding at the rate of 27½ percent.
[4] Subject to the provisions of Article XI (2) of the tax convention and protocol between the United States and Canada (see §§ 7.10 to 7.17, inclusive, of this chapter.)

II. FOR THE PERIOD ON AND AFTER OCTOBER 31, 1942

Classes of taxpayers	Corporate bond interest			Salary or other compensation for personal services	Other fixed or determinable annual or periodical income, including dividends, from sources within the United States
	With tax-free covenant and issued before Jan. 1, 1934		Without tax-free covenant or issued on or after Jan. 1, 1934, with tax-free covenant		
	If corporation assumes over 2 per cent of the tax	If corporation assumes not over 2 percent of the tax			
1. Citizen or resident individual, fiduciary, or partnership	Percent 2	Percent 2	Percent	Percent	Percent
2. Nonresident individual, fiduciary, or partnership	2	30	30	[1] 30	[2] 30
3. Domestic corporation or resident foreign corporation					
4. Nonresident foreign corporation	2	30	30	30	[2] 30
5. Nonresident alien, fiduciary, or partnership, resident of Canada, or nonresident corporation organized under the laws of Canada	2	15	15	30	[4] 15
6. Unknown owner	2	30	30		(5)

[1] Salary or compensation for personal services rendered in the United States is not subject to withholding in the case of nonresident aliens, residents of Canada or Mexico, who enter and leave the United States at frequent intervals.
[2] In the case of a resident of Sweden or a corporation or other entity organized under the laws of Sweden the rate with respect to dividends is 10 percent for at least two years beginning Jan. 1, 1940.
[3] Interest on any noncorporate security the owner of which is unknown to the withholding agent is subject to withholding at the rate of 30 percent.
[4] Such rate was effective June 27, 1942. In the case of dividends within the provisions of Article XI(2) of the tax convention between the United States and Canada, the rate is 5 percent.

SEC. 145. PENALTIES [as amended by secs. 136 (b) (c), 172 (f), Rev. Act 1942; sec. 5 (c), Current Tax Payment Act 1943].

(a) *Failure to file returns, submit information, or pay tax.* Any person required under this chapter to pay any estimated tax or tax, or required by law or regulations made under authority thereof to make a return or declaration, keep any records, or supply any information, for the purposes of the computation, assessment, or collection of any estimated tax or tax imposed by this chapter, who willfully fails to pay such estimated tax or tax, make such return or declaration, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than one year, or both, together with the costs of prosecution.

(b) *Failure to collect and pay over tax, or attempt to defeat or evade tax.* Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(c) Any individual who willfully makes and subscribes a return which he does not believe to be true and correct as to every material matter, shall be guilty of a felony, and, upon conviction thereof, shall be subject to the penalties prescribed for perjury in section 125 of the Criminal Code.

(d) *Person defined.* The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

(e) *Cross reference.* (1) For penalties for failure to file information returns with respect to foreign personal holding companies and foreign corporations, see section 340.

(2) For additional penalties for fraudulent receipts or failure to furnish receipts required by section 469, see section 470.

§ 29.145-1 *Penalties.* The penalties provided for in section 145 cannot be assessed but are enforceable only by suit or prosecution. For limitations on prosecutions, see section 3748. The willful failure of a taxpayer to give information required in his return as to advice or assistance rendered in the preparation of the return, and the willful failure of the person preparing a return for another to execute the sworn statement required with reference thereto, make such persons subject to the penalties imposed by section 145 (a). An individual who willfully makes and subscribes a return which he does not believe to be true and correct as to every material matter, is guilty of a felony, and, if convicted, may be fined not more than $2,000 and imprisoned not more than five years (see Criminal Code, section 125, 18 U. S. C., 231). The privilege against incrimination in the fifth amendment to the Constitution is not a defense to a charge of failure to file a return, and does not authorize a refusal to state the amount of income, though the taxpayer's income was made through crime.

SEC. 146. CLOSING BY COMMISSIONER OF TAXABLE YEAR.

(a) *Tax in jeopardy*—(1) *Departure of taxpayer or removal of property from United States.* If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commisisoner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

(2) *Corporation in liquidation.* If the Commissioner finds that the collection of the tax of a corporation for the current or last preceding taxable year will be jeopardized by the distribution of all or a portion of the assets of such corporation in the liquidation of the whole or any part of its capital stock, the Commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so

declared terminated and of the tax for the last preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable.

(b) *Security for payment.* A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this section, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress.

(c) *Same; exemption from section.* If security is approved and accepted pursuant to the provisions of this section and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this section prior to the expiration of the time otherwise allowed for paying such respective taxes.

(d) *Citizens.* In the case of a citizen of the United States or of a possession of the United States about to depart from the United States the Commissioner may, at his discretion, waive any or all of the requirements placed on the taxpayer by this section.

(e) *Departure of alien.* No alien shall depart from the United States unless he first procures from the collector or agent in charge a certificate that he has complied with all the obligations imposed upon him by the income, war-profits, and excess-profits tax laws.

(f) *Addition to tax.* If a taxpayer violates or attempts to violate this section there shall, in addition to all other penalties, be added as part of the tax 25 per centum of the total amount of the tax or deficiency in the tax, together with interest at the rate of 6 per centum per annum from the time the tax became due.

§ 29.146–1 *Termination of the taxable period by Commissioner.* (a) Section 146 provides that in the case of a taxpayer who designs by immediate departure from the United States or otherwise to avoid the payment of the tax for the preceding or current taxable year, the Commissioner may upon evidence satisfactory to him, declare the taxable period for such taxpayer immediately terminated and cause to be served upon him notice and demand for immediate payment of the tax for the taxable period declared terminated, and of the tax for the preceding taxable year, or so much of such tax as is unpaid. In such a case the taxpayer is entitled to the personal exemption and credit for dependents, if otherwise allowable, but the amount allowable as personal exemption and credit for dependents shall be reduced proportionately to the length of the period for which the return is made. If suit is necessary to collect a tax made due and payable by the provisions of section 146 (a) (1), the Commissioner's finding is presumptive evidence of the taxpayer's design. Section 146 (a) (2) provides for a similar termination of the taxable period of a corporation if the Commissioner finds that the collection of the tax of the corporation for the current or last preceding taxable year will be jeopardized by the distribution of all or a portion of the assets of such corporation in the liquidation of the whole or any part of its capital stock. Such a finding of the Commissioner is considered prima facie correct. A taxpayer who is not in default in making the returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes which are or may be due pursuant to this section by depositing with the Commissioner United States bonds of a principal amount not exceeding double the amount of taxes due for the taxable period, or by furnishing such other security as may be approved by the Commissioner.

(b) Except as provided in paragraph (c) of this section an alien who intends to depart from the United States will be required to file a return of income on Form 1040C and to obtain a certificate of compliance with income tax obligations from the collector or internal revenue agent in charge. A certificate of compliance is attached to and made a part of Form 1040C. An alien, whether resident or nonresident, who intends to depart from the United States should appear before the collector or internal revenue agent in charge for the district in which he resides and satisfy all income tax obligations with respect to income received or to be received, determined as nearly as may be, up to and including the date of his intended departure. Upon payment of such obligations, or upon the furnishing of such security as may be approved by the Commissioner for the payment of such obligations, or upon satisfactory evidence that no tax is due and payable, the collector or internal revenue agent in charge will issue a certificate of compliance to the applicant. A properly executed certificate of compliance issued by the collector or internal revenue agent must be presented at the point of departure. An alien presenting himself at the point of departure without such certificate of compliance will be examined by an internal revenue officer at that point and such taxes as appear to be due and owing will be collected. Citizens of the United States or of possessions of the United States departing from the United States will not be required to procure certificates of compliance or to present any other evidence of compliance with income tax obligations.

(c) An alien who intends to depart from the United States and whose taxable year has not been terminated by the Commissioner as provided in section 146 (a), and who is not in default in making any return, or paying income, war-profits, or excess-profits tax under any Act of Congress, may procure a certificate of compliance as provided in section 146 (e) by (1) appointing in writing on Form 934 an attorney in fact, resident in the United States, to make his income tax return or returns for the taxable year current at the time of his intended departure and for the next preceding taxable year (if not already made), (2) making on Form 1040D a return of information for his taxable year current at the time of his intended departure and a return on that form for the next preceding taxable year where the period for making the income tax return for the next preceding taxable year has not expired, and (3) either paying the estimated tax as shown on the information return (Form 1040D), which will be credited on account for the year covered by such return, or furnishing security approved by the Commissioner that he will make the required return or returns and pay the tax or taxes required to be paid. If such security is approved and accepted and such further security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes may be postponed until the expiration of the time otherwise allowed for their payment. The departing alien may furnish as security a surety bond on Form 1133 in an amount not exceeding double the amount of tax for his taxable year current at the time of his intended departure, and for the next preceding taxable year (if not already paid), conditioned upon the making of his return or returns for such year or years (if not already made), and the payment of any tax or taxes that may become payable for such year or years together with any penalty and interest that may accrue thereon, such bond to be executed by a surety or sureties approved by the Commissioner. In lieu of such surety bond, the taxpayer may furnish as security a penal bond (Form 1133), approved by the Commissioner, secured by deposit of bonds or notes of the United States equal in their total par value to an amount not exceeding double the amount of the tax or taxes in respect of which the bond is furnished. A form of a "certificate of compliance" is made a part of Form 1040D. Bonds complying with the provisions of this section, if properly executed and with adequate surety, are approved, and may be accepted in the name of the Commissioner, by the collector or internal revenue agent in charge by signing the Form 1133 as follows:

_____
Commissioner of Internal Revenue.
By _____
(Collector of Internal Revenue.)
_____
(Internal Revenue Agent in Charge.)

A corporation will not be accepted as a surety on such bond unless the corporation holds a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds. If the surety on the bond is an individual or individuals such bonds shall not be accepted until an investigation is made as to the financial and other responsibility of such surety or sureties and such investigation shows that the collection of the tax is amply secured by the bond.

SEC. 147. INFORMATION AT SOURCE [As amended by sec. 7 (c), Rev. Act 1940; secs. 112 (c), 116 (a) (b), Rev. Act 1941; sec. 131 (c), Rev. Act 1942].

(a) *Payments of $500 or more.* All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another person, of interest, rent,

salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in section 148 (a) or 149), of $500 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

(b) *Returns regardless of amount of payment.* Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, (2) in the case of payments of interest upon obligations of the United States or any agency or instrumentality thereof, and (3) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

(c) *Recipient to furnish name and address.* When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

§ 29.147-1 *Return of information as to payments of $500.* All persons making payment to another person of fixed or determinable income of $500 or more in any calendar year must render a return thereof to the Commissioner for such year on or before February 15 of the following year, except as specified in §§ 29.147-3 to 29.147-5, inclusive. A return shall be made in each case on Form 1099, accompanied by transmittal Form 1096 showing the number of returns filed, except that the return with respect to distributions to beneficiaries of a trust or of an estate shall be made on Form 1041 in lieu of Forms 1099 and 1096. The street and number where the recipient of the payment lives should be stated, if possible. If no present address is available, the last known post-office address must be given. Although to make necessary a return of information the income must be fixed or determinable, it need not be annual or periodical. (See § 29.143-2.)

Sums paid in respect of life insurance, endowment, or annuity contracts which are required to be included in gross income under §§ 29.22 (b) (1)-1, 29.22 (b) (2)-1, and 29.22 (b) (2)-2 come within the meaning of the term "fixed or determinable income" and are required to be reported in returns of information as required by this section, except that payments in respect of policies surrendered before maturity and lapsed policies need not be reported.

Fees for professional services paid to attorneys, physicians, and members of other professions come within the meaning of the term "fixed or determinable income" and are required to be reported in returns of information as required by this section.

For the purposes of a return of information, an amount is deemed to have been paid when it is credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and which is made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition.

§ 29.147-2 *Return of information as to payments to employees.* The names of all employees to whom payments of $500 or more are made in any calendar year, whether such total sum is made up of wages, salaries, commissions, or compensation in any other form, must be reported. Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner. When both main office and branch office have adequate records, the return should be filed by the main office. Amounts distributed or made available under an employees' trust governed by the provisions of section 165 to any beneficiary in any taxable year, in excess of the sum of his personal exemption and the amounts paid into the fund by him, must be reported by the trustee. But see § 29.147-3. (See also § 29.22 (a)-3.)

In the case of payments made by the United States to persons in its service (civil, military, or naval) of wages, salaries, or compensation in any other form, the returns of information shall be made by the heads of the executive departments and other United States Government establishments.

§ 29.147-3 *Cases where no return of information required.* Payments of the following character, although more than $500 during a calendar year, need not be reported in returns of information on Form 1099:

(a) Payments by a broker to his customers;

(b) Payments of any type made to corporations;

(c) Bills paid for merchandise, telegrams, telephone, freight, storage, and similar charges;

(d) Payments of rent made to real estate agents (but the agent must report payments to the landlord if the amount paid during the calendar year was $500 or more);

(e) Payments made to alien employees serving in foreign countries or payments representing earned income for services rendered without the United States made to nonresident citizens entitled to the benefits of section 116 (a);

(f) Salaries and profits paid or distributed by a partnership to the individual partners;

(g) Payments of salaries, or other compensation for personal services aggregating less than $1,200 for a calendar year, made to a married individual (citizen or resident);

(h) Payments of commissions made by fire insurance companies, or other companies insuring property, to general agents, except when specifically directed by the Commissioner to be filed;

(i) Payments of income upon which income tax has been withheld at the source and reported on Forms 1012, 1013, 1042, or Forms V-1, V-2, and V-3; and

(j) Amounts paid by the United States to persons in its service (civil, military, or naval) as an allowance for traveling expenses, including an allowance for meals and lodgings, as, for example, a per diem allowance in lieu of subsistence, and amounts paid as reimbursements for traveling expenses.

If the marital status of the payee is unknown to the payor, or if the marital status of the payee changed during the year (see § 29.25-7), or if the payee is a resident of Canada or Mexico, the payee will be considered a single person for the purpose of filing a return of information on Form 1099 with respect to payments of salaries or other compensation for personal services.

§ 29.147-4 *Return of information as to certain interest.* In the case of payments of interest, regardless of amount, upon bonds and similar obligations of corporations, and interest on obligations of the United States or any agency or instrumentality thereof, the ownership certificates, when duly filed, shall constitute and be treated as returns of information and in such cases no return of information on Form 1099 is required. (See § 29.143-5.) (As to the requirements of filing ownership certificates for bond interest generally in the case of a nonresident alien, a nonresident partnership composed in whole or in part of nonresident aliens, a nonresident foreign corporation or where the owner is unknown, and with respect only to interest on obligations containing a tax-free covenant and issued prior to January 1, 1934, in the case of a citizen or resident of the United States, a resident partnership and nonresident partnership all the members of which are citizens or residents of the United States, see § 29.143-4.)

§ 29.147-5 *Return of information as to payments to other than citizens or residents.* In the case of payments of fixed or determinable annual or periodical income to nonresident aliens (individual or fiduciary), to nonresident partnerships composed in whole or in part of nonresident aliens, or to nonresident foreign corporations (see § 29.3797-8), the returns filed by withholding agents on Form 1042 shall constitute and be treated as returns of information. (See sections 143 and 144.)

§ 29.147-6 *Foreign items.* The term "foreign items," as used in these regulations, means any item of interest upon the bonds of a foreign country or of a nonresident foreign corporation not having a fiscal or paying agent in the United States, or any item of dividends upon the stock of such corporation.

§ 29.147-7 *Return of information as to foreign items.* In the case of foreign

items, an information return on Form 1099 is required to be filed by the bank or collecting agent accepting the items for collection, if the foreign item is paid to a citizen or resident of the United States (individual or fiduciary), or a partnership any member of which is a citizen or resident, and if the amount of the foreign items paid in any taxable year to an individual, a partnership, or a fiduciary is $500 or more. Such forms accompanied by Form 1096 should be forwarded to the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D. C., on or before February 15 of each year. The term "collection" includes the following: (a) The payment by the licensee of the foreign item in cash; (b) the crediting by the licensee of the account of the person presenting the foreign item; (c) the tentative crediting by the licensee of the account of the person presenting the foreign item until the amount of the foreign item is received by the licensee from abroad; and (d) the receipt of foreign items by the licensee for the purpose of transmitting them abroad for deposits. (See §§ 29.147–1 and 29.147–3.)

§ 29.147–8 *Information as to actual owner.* When the person receiving a payment falling within the provisions of the Internal Revenue Code for information at the source is not the actual owner of the income received, the name and address of the actual owner or payee shall be furnished upon demand of the individual, corporation, or partnership paying the income, and in default of a compliance with such demand the payee becomes liable for the penalties provided. (See section 145.) Dividends on stock are prima facie the income of the record owner of the stock. Upon receipt of dividends by a record owner, he should execute Form 1087 to disclose the name and address of the actual owner or payee. Form 1087 should be filed with the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D. C., not later than February 15 of the succeeding year. Unless such a disclosure is made, the record owner will be held liable for any tax based upon such dividends. (See § 29.148–1.)

The filing of Form 1087 is not required (a) if the record owner is required to file a fiduciary return on Form 1041, or a withholding return on Form 1042, disclosing the name and address of the actual owner or payee, or (b) if the actual owner or payee is a nonresident alien individual, foreign partnership, or foreign corporation and the tax has been withheld at the source prior to receipt of the dividends by the record owner. (See § 29.143–1.)

SEC. 148. INFORMATION BY CORPORATIONS [as amended by sec. 407, Rev. Act 1939].

(a) *Dividend payments.* Every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him.

(b) *Profits declared as dividends.* Every corporation shall, when required by the Commissioner, furnish him a statement of such facts as will enable him to determine the portion of the earnings or profits of the corportion (including gains, profits, and income not taxed) accumulated during such periods as the Commissioner may specify, which have been distributed or ordered to be distributed, respectively, to its shareholders during such taxable years as the Commissioner may specify.

(c) *Accumulated earnings and profits.* When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of accumulated earnings and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if dividend or distributed, and of the amounts that would be payable to each.

(d) *Contemplated dissolution or liquidation.* Every corporation shall, within thirty days after the adoption by the corporation of a resolution or plan for the dissolution of the corporation or for the liquidation of the whole or any part of its capital stock, render a correct return to the Commissioner, verified under oath, setting forth the terms of such resolution or plan and such other information as the Commissioner shall, with the approval of the Secretary, by regulations prescribe.

(e) *Distributions in liquidation.* Every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its distributions in liquidation, stating the name and address of each shareholder, the number and class of shares owned by him, and the amount paid to him or, if the distribution is in property other than money, the fair market value (as of the date the distribution is made) of the property distributed to him.

(f) *Compensation of officers and employees.* Under regulations prescribed by the Commissioner with the approval of the Secretary, every corporation subject to taxation under this chapter shall, in its return, submit a list of the names of all officers and employees of such corporation and the respective amounts paid to them during the taxable year of the corporation by the corporation as salary, commission, bonus, or other compensation for personal services rendered, if the aggregate amount so paid to the individual is in excess of $75,000.

The Secretary shall compile from the returns made a list containing the names of, and the amounts paid to, each such officer and employee and the name of the paying corporation, and shall make such list available to the public. It shall be unlawful for any person to sell, offer for sale, or circulate, for any consideration whatsoever, any copy or reproduction of any list, or part thereof, authorized to be made public by this Act or by any prior Act relating to the publication of information derived from income-tax returns; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court: *Provided*, That nothing in this sentence shall be construed to be applicable with respect to any newspaper, or other periodical publication, entitled to admission to the mails as second-class mail matter.

§ 29.148–1 *Return of information as to payments of dividends.* Section 148 provides that every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him. In accordance with that section, returns of information in respect of dividend payments shall be rendered for each calendar year as follows:

(a) Except as provided in paragraph (b) of this section, every domestic corporation or foreign corporation engaged in business within the United States or having an office or place of business or a fiscal or paying agent in the United States, making payments of dividends and distributions (other than distributions in liquidation) to any shareholder who is an individual (citizen or resident of the United States), a resident fiduciary, or a resident partnership any member of which is a citizen or resident, amounting to $100 or more during each calendar year, shall render an information return on Forms 1096 and 1099. A separate Form 1099 must be prepared for each shareholder, upon which will be shown the name and address of the shareholder to whom such payment was made, and the amount paid. These forms, accompanied by a letter of transmittal on Form 1096 showing the number of Forms 1099 filed therewith, shall be filed with the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D. C., on or before February 15 of the following year.

The periodical distributions of earnings on running installment shares of stock paid or credited by a building and loan association to its holders of that class of stock are dividensd within the meaning of section 115 (a). The sum received upon withdrawal from a building and loan association in excess of the amounts paid in on account of membership fees and stock subscriptions, consisting of accumulated profits, constitutes a dividend within the meaning of section 115 (a). As to when a stock dividend is taxable as a dividend see section 115 (f).

(b) In the case of a distribution which is made from a depletion or depreciation reserve, or which for any other reason is deemed by the corporation to be nontaxable or partly nontaxable to its shareholders, the corporation will fill in the information on both sides of Form 1096 and forward this form, together with Forms 1099, to the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D. C., not later than February 1 of the following year. Upon receipt of this information the Commissioner will advise the corporation by letter as to any apparent errors made by the corporation in computing the nontaxable portion of the distribution in order that the corporation may, if time permits, furnish such advice to its shareholders before the shareholders file their income tax returns for the year in which the distribution was made.

(c) In any case in which it is impossible to file the return within the time prescribed in this section, the corporation may, upon a showing of such fact, obtain a reasonable extension of time for filing the return. The request for the extension of time must be forwarded to the Commissioner of Internal Revenue, Practice and Procedure Division, Washington, D. C., on or before the date prescribed for filing the return.

§ 29.148–2 *Return of information respecting contemplated dissolution or liquidation*—(a) *Making and filing of re-*

turns. Within 30 days after the adoption of any resolution or plan for or in respect of the dissolution of a corporation or the liquidation of the whole or any part of its capital stock, the corporation shall file with the Commissioner of Internal Revenue, Washington, D. C., attention of the Income Tax Unit, Records Division, a correct return on Form 966, made under oath or affirmation and containing the information required by paragraph (b) of this section and by such form. A like return shall be filed by the corporation in the case of any amendment of, or supplement to, a resolution or plan for or in respect of the dissolution of the corporation or the liquidation of the whole or any part of its capital stock. A return must be filed under section 148 (d) in respect of a liquidation whether or not any part of the gain or loss to the shareholders upon the liquidation is recognized under the provisions of section 112.

(b) *Contents of return*—(1) *General.* There shall be attached to and made a part of the return required by section 148 (d) and paragraph (a) of this section a certified copy of the resolution or plan, together with any amendments thereof or supplements thereto, and such return shall in addition contain the following information:

(i) The name and address of the corporation;

(ii) The place and date of incorporation;

(iii) The date of the adoption of the resolution or plan and the dates of any amendments thereof or supplements thereto; and

(iv) The collection district in which the last income tax return of the corporation was filed and the taxable year covered thereby.

(2) *Returns in respect of amendments or supplements.* If a return in respect of any resolution or plan for or in respect of the dissolution of a corporation or the liquidation of the whole or any part of its capital stock has already been filed pursuant to section 148 (d), a return in respect of any amendment thereof or supplement thereto will be deemed sufficient if it gives the date such prior return was filed and contains a duly certified copy of such amendment or supplement and all other information required by this section and by Form 966 which was not given in such prior return. If no return was filed relative to the resolution or plan which is being amended or supplemented, the return relative to the amendment thereof or supplement thereto shall contain a duly certified copy of the resolution or plan which is being amended or supplemented, together with all amendments thereof and supplements thereto, and all other information required by this section and by Form 966.

§ 29.148–3 *Return of information respecting distributions in liquidation.* Unless the distribution is one in respect of which information is required to be filed pursuant to § 29.112 (b) (6)–5 (b), 29.112 (g)–6 (a), or 29.371–10, every corporation making any distribution of $500 or more during a calendar year to any shareholder in liquidation of the whole or any part of its capital stock shall file a return of information on Forms 1096 and 1099L, giving all the information required by such forms and by these regulations. A separate Form 1099L must be prepared for each shareholder to whom such distribution was made, showing the name and address of such shareholder, the number and class of shares owned by him in liquidation of which such distribution was made, and the total amount distributed to him on each class of stock. If the amount distributed to such shareholder on any class of stock consisted in whole or in part of property other than money, the return on such form shall in addition show the amount of money distributed, if any, and shall list separately each class of property other than money distributed, giving a description of the property in each such class and a statement of its fair market value at the time of the distribution.

Such forms, accompanied by a letter of transmittal on Form 1096 showing the number of Forms 1099L filed therewith, shall be filed with the Commissioner of Internal Revenue, Returns Distribution Section, Washington, D. C., on or before February 15 of the year following the calendar year in which such distribution was made.

§ 29.148–4 *Information respecting compensation of officers and employees in excess of $75,000.* Every corporation subject to taxation under chapter 1 which during any taxable year has paid to any officer or employee of the corporation, salary, commission, bonus, or other compensation for personal services rendered, in an aggregate amount in excess of $75,000 (in whatever form paid), shall in respect of each such taxable year, make and file, in duplicate, a schedule on the form prescribed by the Commissioner, as a part of its income tax return, in accordance with the instructions contained in the prescribed return. Such schedule shall contain the following information: (1) Name of officer or employee, (2) amount of salary paid, (3) amount of commission paid, (4) amount of bonus paid, (5) amount of other compensation paid, and (6) total compensation paid.

The term "paid" as used in this section means "paid or accrued" or "paid or incurred" which shall be construed according to the method of accounting upon the basis of which the net income of the corporation is computed.

Upon receipt of the returns by the collector, the schedules will be detached and forwarded by the collector to the Commissioner of Internal Revenue, Records Division, Washington, D. C.

SEC. 149. RETURNS OF BROKERS.

Every person doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such person has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

SEC. 150. COLLECTION OF FOREIGN ITEMS.

All persons undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the Government to obtain the information required under this chapter as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall be fined not more than $5,000 or imprisoned for not more than one year, or both.

§ 29.150–1 *License to collect foreign items.* Banks or agents collecting foreign items, as defined in § 29.147–6, and required by §29.147–7 to make returns of information with respect thereto, must obtain a license from the Commissioner to engage in such business. Application Form 1017 for such license may be procured from collectors. The license is issued without cost on Form 1010. Any person holding a license under the Revenue Act of 1938 or any prior Act will not be required to renew such license.

SEC. 151. FOREIGN PERSONAL HOLDING COMPANIES.

For information returns by officers, directors, and large shareholders, with respect to foreign personal holding companies, see sections 338, 339, and 340.

For information returns by attorneys, accountants, and so forth, as to formation, and so forth, of foreign corporations, see section 3604.

ESTATES AND TRUSTS

SEC. 161. IMPOSITION OF TAX.

(a) *Application of tax.* The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and payment.* The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

(c) *Cross reference.* For return made by beneficiary, see section 142.

§ 29.161–1 *Imposition of the tax*—(a) *Scope.* Supplement E (sections 161 to 172, inclusive) prescribes that the taxes imposed upon individuals by chapter 1 shall be applicable to the income of estates or of any kind of property held in trust. The rate of tax, the statutory provisions respecting gross income, and, with certain exceptions, the deductions and credits allowed to individuals apply also to estates and trusts.

The several classes enumerated and described in the four paragraphs of sec-

tion 161 (a), and which are introduced by the word "including," do not exclude others which also may come within the general purpose of that subsection.

A guardian, whether of an infant or other person, is a fiduciary (see section 3797 (a) (6)), and, as such, is required to make and file the return for his ward and pay the tax, or the return may be made by the ward. (See §§ 29.51–1 and 29.142–2.) The estate of a ward is not a taxable entity, in that respect differing from the estate of a deceased person or of a trust.

The provisions of sections 161, 162, and 163 (relating to estates and trusts, fiduciaries, and beneficiaries) contemplate that the corpus of the trust, or the income therefrom, is, within the meaning of the Internal Revenue Code, no longer to be regarded as that of the grantor. If, by virtue of the nature and purpose of the trust, the corpus or income therefrom remains attributable to the grantor, these provisions do not apply. Thus the provisions of sections 166 and 167 deal with certain trusts which are excluded from the scope of sections 161, 162, and 163. Other trusts, not specified in sections 166 and 167, where in contemplation of law the corpus of the trust or the income therefrom is regarded as remaining in substance that of the grantor are likewise excluded from the scope of sections 161, 162, and 163. Some of such trusts are dealt with in §§ 29.166–1 and 29.167–1. So-called alimony trusts to which section 22 (k) or section 171 applies may be of a type to which the provisions of sections 161, 162, and 163 also apply, or of a type which is excluded from the provisions of sections 161, 162, and 163. Except to the extent that section 22 (k) or section 171 governs the taxability of amounts paid, credited, or to be distributed attributable to trust property, the treatment of such trusts under sections 161, 162, and 163 or under sections 166 and 167 is not affected by section 22 (k) or section 171. See section 165 as to the exemptions of employees' trusts.

(b) *Taxability of the income.* The fiduciary is required to make and file the return and pay the tax on the net income of the estate or trust except as otherwise provided in sections 165, 166, and 167, and §§ 29.166–1 and 29.167–1. In determining whether there is any net income subject to tax and the amount thereof, consideration is to be given to the additional deductions authorized in section 162.

SEC. 162. NET INCOME [as amended by secs. 111(b)(c), 161(a), Rev. Act 1942].

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary;

(d) *Rules for application of subsections* (b) *and* (c). For the purposes of subsections (b) and (c)—

(1) *Amounts distributable out of income or corpus.* In cases where the amount paid, credited, or to be distributed can be paid, credited, or distributed out of other than income, the amount paid, credited, or to be distributed (except under a gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals) during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid, credited, or to be distributed if the aggregate of such amounts so paid, credited, or to be distributed does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts so paid, credited, or to be distributed during the taxable year of the estate or trust in such cases exceeds the distributable income of the estate or trust for its taxable year, the amount so paid, credited, or to be distributed to any legatee, heir, or beneficiary shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of such distributable income as the amount so paid, credited, or to be distributed to the legatee, heir, or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to legatees, heirs, and beneficiaries for the taxable year of the estate or trust. For the purposes of this paragraph "distributable income" means either (A) the net income of the estate or trust computed with the deductions allowed under subsections (b) and (c) in cases to which this paragraph does not apply, or (B) the income of the estate or trust minus the deductions provided in subsections (b) and (c) in cases to which this paragraph does not apply, whichever is the greater. In computing such distributable income the deductions under subsections (b) and (c) shall be determined without the application of paragraph (2).

(2) *Amounts distributable out of income of prior period.* In cases, other than cases described in paragraph (1), if on a date more than 65 days after the beginning of the taxable year of the estate or trust, income of the estate or trust for any period becomes payable, the amount of such income shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed to the extent of the income of the estate or trust for such period, or if such period is a period of more than 12 months, the last 12 months thereof.

(3) *Distributions in first 65 days of taxable year*—(A) *General rule.* If within the first 65 days of any taxable year of the estate or trust, income of the estate or trust, for a period beginning before the beginning of the taxable year, becomes payable, such income, to the extent of the income of the estate or trust for the part of such period not falling within the taxable year or, if such part is longer than 12 months, the last 12 months thereof, shall be considered, paid, credited, or to be distributed on the last day of the preceding taxable year. This subparagraph shall not apply with respect to any amount with respect to which subparagraph (B) applies.

(B) *Payable out of income or corpus.* If within the first 65 days of any taxable year of the estate or trust, an amount which can be paid at intervals out of other than income becomes payable, there shall be considered as paid, credited, or to be distributed on the last day of the preceding taxable year the part of such amount which bears the same ratio to such amount as the part of the interval not falling within the taxable year bears to the period of the interval. If the part of the interval not falling within the taxable year is a period of more than 12 months, the interval shall be considered to begin on the date 12 months before the end of the taxable year.

(e) Amounts allowable under section 812 (b) as a deduction in computing the net estate of a decedent shall not be allowed as a deduction under section 23, except subsection (w), in computing the net income of the estate unless there is filed, within the time and in the manner and form prescribed by the Commissioner, a statement that the items have not been claimed or allowed as deductions under section 812 (b) and a waiver of the right to have such items allowed at any time as deductions under section 812 (b).

SEC. 111. INCOME RECEIVED FROM ESTATES, ETC., UNDER GIFTS, BEQUESTS, ETC. (Revenue Act of 1942.)

* * * * *

(e) *Taxable years to which amendments applicable.* The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1941; except that in the case of income paid, credited or to be distributed or amounts paid, credited or to be distributed by an estate or trust the amendments made by this section shall be applicable only with respect to such income and such amounts paid, credited or to be distributed on or after the beginning of the first taxable year of the estate or trust, as the case may be, beginning after December 31, 1941.

§ 29.162–1 *Income of estates and trusts.* In ascertaining the tax liability of the estate of a deceased person or of a trust, there is deductible from the gross income, subject to exceptions, the same deductions which are allowed to individual taxpayers. See generally section 23, and the provisions thereof governing the right of deduction for depreciation and depletion in the case of property held in trust. Amounts allowable under section 812 (b) as a deduction in computing the net estate of a decedent are not allowed as a deduction under section 23, except subsection (w), in computing the net income of the estate unless there is filed in duplicate with the return in

which the item is claimed as a deduction a statement to the effect that the items have not been claimed or allowed as deductions from the gross estate of the decedent under section 812 (b) and a waiver of any and all right to have such item allowed at any time as a deduction under section 812 (b). For items not deductible, see section 24. Against the net income of the estate or trust there are allowable certain credits, for which see sections 25 and 163.

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

(a) Any part of the gross income of the estate or trust for its taxable year which, by the terms of the will or of the instrument creating the trust, is paid or permanently set aside during such year for the charitable, etc., uses or purposes referred to or described in section 162 (a). This deduction is in lieu of that authorized by section 23 (o) in the case of individual taxpayers.

(b) Any income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to a legatee, heir, or beneficiary, whether or not such income is actually distributed. For this purpose, it is provided in section 162 (b) that "income which is to be distributed currently" includes income of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary.

(c) Any income of the estate of a deceased person for its taxable year which is properly paid or credited during such year to a legatee or heir, and any income either of such an estate or of a trust for its taxable year which is similarly paid or credited during that year to a legatee, heir, or beneficiary if there was vested in the fiduciary a discretion either to distribute or to accumulate such income.

Any income of the class described in either (b) or (c) of this section, which is currently distributable, or paid or credited, to a guardian for his ward is likewise deductible from the gross income of the estate or trust.

There is included in the income of the estate or the trust, unless it is included in the income of the grantor of the trust (see §§ 29.166–1 and 29.167–1):

(1) All income thereof accumulated for the benefit of unborn or unascertained persons or persons with contingent interests,

(2) All income either accumulated or held for future distribution pursuant to the terms of the will or trust,

(3) All other income of the estate or trust for its taxable year which is not to be distributed currently to legatees or other beneficiaries (see (b) of this section),

(4) All income of the estate for its taxable year not properly paid or credited during such year to a legatee or heir, and

(5) All income either of the estate or of the trust for its taxable year which is not similarly paid or credited during that year to a legatee, heir, or beneficiary in case there was vested in the fiduciary a discretion either to distribute or to accumulate such income (see (c) of this section).

In all such cases the tax with respect to such income included in the income of the estate or trust for its taxable year is payable by the fiduciary, except where the income is taxable to the grantor of the trust or where, as provided in the next paragraph, it is deductible by the estate or trust for such taxable year (and is includible in the income of the legatee or beneficiary).

Income described in subparagraphs (1), (2), (4), and (5) of paragraph (c) may, in some cases, be deductible by the estate or trust under (b) of this section. It is expressly provided in section 162 (b) that such income of the estate or trust for its taxable year which, within its taxable year, becomes payable to the legatee, heir, or beneficiary is deductible by the estate or trust. Thus, if income of a trust is to be accumulated until A, the beneficiary, reaches his twenty-first birthday, which is December 31, 1942, the income of the trust (assuming the income tax returns of the trust are made on the calendar year basis) for the calendar year 1942 is to be deducted by the trust under section 162 (b) in computing its net income for 1942 and is to be included in the income of A for his taxable year in which December 31, 1942, falls. In the case of a similar trust, where the twenty-first birthday of B, the beneficiary, was on July 1, 1942, and the income of the trust was to be accumulated until that date and then to be distributed to B at such time as the trustee in his discretion decides, if the trustee on December 31, 1942, decides to distribute the accumulated income to B, the income becomes payable to B on December 31, 1942, whether distributed to him or not. In such a case, the extent to which such amount is considered to be payable out of income of the trust for its taxable year is determined under section 162 (d) (2) and § 29.162–2 (b).

Any amount described in (b) and (c) of this section as being deductible from the gross income of the estate or trust shall be included in computing the net income of the legatees, heirs, or beneficiaries, whether distributed to them or not. As to the amount of income of the estate or trust which is considered paid, credited, or to be distributed, and the time thereof, for the purposes of the deduction under (b) and (c) of this section and the inclusion in income of the legatee, heir, or beneficiary, see section 162 (d) and § 29.162–2.

Any income of an estate or trust for its taxable year which during that year may be used, pursuant to the terms of the will or trust instrument, in the discharge or satisfaction, in whole or in part, of a legal obligation of any person is, to the extent so used, taxable to such person as though directly distributed to him as a beneficiary, except in cases to which section 22 (k) or section 171 applies. (See §§ 29.167–1, 29.171–1, and 29.171–2.)

The income of an estate of a deceased person, as dealt with in the Internal Revenue Code, is therein described as received by the estate during the period of administration or settlement thereof. The period of administration or settlement of the estate is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. If an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. But see sections 42, 43, and 44. As to the taxable gain realized, or the deductible loss sustained, upon the sale or other disposition of property by an administrator, executor, or trustee, and by a legatee, heir, or other beneficiary, see sections 111 and 112. As to capital gains and losses, see section 117. A statutory allowance paid a widow is not deductible from gross income, except to the extent that under the principles of § 29.162–2 such allowance is taxable to the widow. If real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, he is taxable individually on any profit derived.

The tax upon the net income of the estate or trust shall be paid by the fiduciary (see section 161 (b)). If the tax has been properly paid on the net income of an estate or trust for any taxable year, the net income on which the tax is so paid is not, generally, in the hands of the distributee thereof (the legatee, heir, or beneficiary) taxable as income to him, but such income, to the extent it becomes payable in a subsequent taxable year of the estate or trust to the distributee after the first 65 days of such subsequent taxable year, may be required to be included in the income of the distributee under section 162 (d) (2). See § 29.162–2 (b).

Liability for the payment of the tax attaches to the person of the executor or administrator up to and after his discharge if prior to distribution and discharge he had notice of his tax obligations or failed to exercise due diligence in ascertaining whether or not such obligations existed. For the extent of such liability, see section 3467 of the Revised Statutes, as amended by section 518 of the Revenue Act of 1934. Liability for the tax also follows the assets of the estate distributed to heirs, devisees, legatees, and distributees, who may be required to discharge the amount of the tax due and unpaid to the extent of the distributive shares received by them. (See section 311.) The same considerations apply to trusts.

§ 29.162–2 *Allocation of estate and trust income to legatees and beneficiaries*—(a) *Allocation among annuitants.*

Section 162 (d) (1) applies to all cases in which the executor or trustee can or must (for example, by the terms of the trust instrument or will) pay the whole or any part of a gift, bequest, devise, or inheritance out of other than income, except that no income is to be allocated under it to a legatee, heir, or beneficiary of a lump sum gift, bequest, devise, or inheritance. It applies in all cases of annuities where any deficiency in the amount to be paid can be made up by a payment out of corpus of the trust. It also applies in cases where amounts are to be paid or credited at intervals and the executor or trustee has discretion whether to pay or credit such amounts out of income or corpus, regardless of the source (income or corpus) to which the executor or trustee attributes such amount. If an annuity is paid, credited, or to be distributed tax-free, that is, under a provision whereby the executor or trustee will pay the income tax of the annuitant resulting from the receipt of the annuity, the payment of or for the tax by the executor or trustee will be income to the annuitant under the rules of section 162 (d) to the extent such payment is treated thereunder as out of income.

The method of allocating income of the estate or trust for its taxable year in cases to which section 162 (d) (1) applies is as follows: The aggregate of all amounts which can be paid, credited, or distributed out of other than income (except under a gift, bequest, devise, or inheritance not to be paid, credited, or to be distributed at intervals) is obtained. The aggregate of such amounts is considered to be paid, credited, or distributed in such cases out of income of the estate or trust for its taxable year if it does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts does exceed the distributable income of the estate or trust for its taxable year, the portion of such amount paid, credited, or to be distributed to a legatee or beneficiary is considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of all distributable income as the amount so paid, credited, or to be distributed to the legatee or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to such legatees or beneficiaries for the taxable year of the estate or trust. The proportion stated in the preceding sentence applies only to legatees or beneficiaries of amounts which can be paid, credited, or distributed out of other than income of the estate or trust and, in computing such proportion, the amount of any gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals is not to be included.

Section 162 (d) (1) introduces a concept of distributable income. This is defined in that section as meaning (1) the net income of the estate or trust computed with the deductions allowed under subsections (b) and (c) of section 162 in the case of amounts paid, credited, or to be distributed to which section 162 (d) (1) does not apply, or (2) the income of the estate or trust minus the deductions provided in subsections (b) and (c) of section 162 in the case of amounts paid, credited, or to be distributed to which section 162 (d) (1) does not apply, whichever is greater. "Net income," as thus used, means the statutory net income of the trust under the Internal Revenue Code before the application of section 162 (b) and (c) (but, as stated in the preceding sentence, such amount is to be reduced by the deductions allowed under subsections (b) and (c) of section 162 in the case of amounts to which section 162 (d) (1) does not apply). "Income," as thus used, must be determined in accordance with the following principles: First, such "income" means, in general, the amount which under the applicable law of estates and trusts is considered income available for distribution to the life tenant, legatee, or beneficiary, as the case may be. Second, there must be eliminated from the income of the estate or trust, determined in accordance with the terms of the trust instrument and State law, items of income which are not includible in income of an individual for Federal income tax purposes. Therefore, the "income," referred to in clause (B) of section 162 (d) (1), may exceed net income and thus be treated as distributable income under section 162 (d) in cases where items which are deductible for Federal income tax purposes are, by the terms of the trust instrument or State law, not to be used to reduce income available for distribution but to be allocated to corpus. The application of section 162 (d) (1), in general, may be illustrated by the following example:

Example. Pursuant to the terms of the will of A, a trust is established on January 1, 1942, to pay $5,000 a year to B in quarterly installments at the end of every three months, and upon the death of B to pay the corpus and any accumulated income to his estate. The returns of the trust and of B are made on the calendar year basis. The trust instrument provides that the amount payable to B is to be paid out of income (after payment of trustees' commissions) or out of corpus to the extent income is insufficient. The receipts and expenditures of the trust for 1942 are as follows:

Taxable stock dividend	$1,000
Income from rents	3,000
Tax-exempt interest from State bonds	1,000
Gain from sale of capital asset held 10 months	1,000
Deductible trustees' commissions	200
Other deductible expenditures	1,300

In accordance with the terms of the trust instrument stock dividends are to be allocated to corpus, gain from sale of a capital asset held not more than one year is to be allocated to income, and trustees' commissions are to be charged to income. However, the other expenditures indicated above ($1,300) are of a nature which under the terms of the trust instrument are to be charged to corpus. The distributable income of the trust to be deducted by it for 1942 and included in the beneficiary's income for such year is $3,300, the greater of the statutory net income and the available trust income includible in gross income, determined as follows:

Statutory Net Income (Prior to Application of Section 162 (b) and (c))

Gross income:		
Stock dividend	$1,000	
Rents	3,000	
Long-term capital gain (50 percent taken into account, section 117 (b)	500	
		$4,500
Deductions:		
Trustees' commissions	200	
Other deductible expenses	1,300	
		1,500
Net income		3,000

Trust Income Under Clause (B) of Section 162 (d) (1)

Income:		
Rents	$3,000	
Interest from State bonds	1,000	
Gain on sale of asset	1,000	
		$5,000
Expenses allocated to income:		
Trustee's commissions	200	
Eliminating items not includible in gross income:		
Tax-exempt interest	1,000	
Excluded gain on sale of asset	500	
		1,700
Income determined under section 162 (d) (1) (B)		3,300

"Net income" and "income" for the purpose of section 162 (d) (1) also do not include income of a prior taxable year, even though such income may be considered income of the estate or trust for the current taxable year under section 162 (d) (2). This rule may be illustrated by the following example:

Example. Under the terms of a trust, established in 1925, the trustees are to accumulate the income thereof until A reaches his twenty-first birthday, and then are to pay A such accumulated income, and on each December 31 thereafter, are to pay B $5,000, out of income of the trust, if income is available, or, if not, out of corpus of the trust. A became 21 years of age on June 30, 1942. The returns of the trust and of A and B are made on the calendar year basis. Under section 162 (b), the income of the trust for that part of 1942 on and before June 30, 1942, is to be considered income of the trust for 1942 which is to be distributed currently to A. In computing the distributable income of the trust for 1942 which is to be considered distributed to B in payment of the $5,000 annuity, the amount of income for the first six months of 1942 which is considered to be currently distributable to A is to be deducted. Although under section 162 (d) (2) the amount of the income of the trust for the period July 1, 1941, through June 30, 1942, will be considered income of the trust for 1942 which is to be deducted by the trust and included in A's income for 1942 (see paragraph (b) of this section), for the purposes of section 162 (d) (1) such amount is not to be deducted from the trust's income for 1942 in computing its distributable income considered to be distributed to B and no account is to be taken of the income of the trust for the period July 1, 1941, through December 31, 1941.

(b) *Allocation among income beneficiaries and legatees.* Section 162 (d) (2) applies in cases where income of the estate or trust for any period becomes payable on a date more than 65 days after the beginning of its taxable year. It applies in every case where income of the estate or trust is paid, credited, or to be distributed to a legatee, heir, or beneficiary, other than a legatee, heir, or bene-

ficiary to whom paragraph (a) of this section applies or a legatee, heir, or beneficiary of a lump sum gift, bequest, devise, or inheritance. This paragraph, and not paragraph (a), applies to income paid, credited, or to be distributed to a legatee who, in addition to any part of the principal of an estate, is entitled to receive any income during the administration of the estate or upon its termination, whether payment of such income is made in accordance with directions in the will, or for support as allowed under State law, or by the administrator to the residuary legatee in the ordinary course of administration. The rule stated in the preceding sentence, however, has no application in cases where income may be paid or credited, or is to be distributed under an obligation to pay an amount periodically at all events, whether or not income is available, as in the ordinary case of an annuity. Section 162 (d) (2) also has no application in determining the amount to be included in the income of the estate or trust under section 161 but applies only in determining the amount allowed as deductions under section 162 (b) and (c).

Section 162 (d) (2) applies whether amounts are paid, credited, or to be distributed out of the income of the estate or trust for its current taxable year or out of the income for any period. It includes a rule for allocating income of the estate or trust to the legatees or beneficiaries in cases in which the income of a prior period is paid, credited, or to be distributed to the legatee or beneficiary during the taxable year of the estate or trust. In the absence of proof that any particular period of time is the source of an amount of income which becomes payable within the taxable year, the period from which such income is derived will be presumed to be a period ended with the date the income becomes payable. In such a case the year ended with the date the income becomes payable shall be considered the last 12 months of such period (whether or not other distributions under this paragraph have been made during such last 12 months) and the income which becomes payable shall be considered as derived from the most recently accumulated income for such period.

As used in section 162, the term "income which becomes payable" means income to which the legatee, heir, or beneficiary has a present right, whether or not such income is actually paid. Such right may be derived from the directions in the trust instrument or will to make distributions of income at a certain date, or from the exercise of the fiduciary's discretion to distribute income, or from a recognized present right under the local law to obtain income or compel a distribution of income. Income is not considered to become payable within a taxable year where during the entire taxable year there is only a future right to such income. For example, under valid terms of a trust instrument, income received by a trust during its taxable year is to be accumulated until the twenty-first birthday of the beneficiary (or his prior death), at which time the accumulated income is to be distributed to the beneficiary (or his estate, as the case may be). In such case, the income of the trust received in any taxable year prior to the taxable year of the trust in which the date of distribution occurs (the beneficiary's twenty-first birthday or his prior death) is not income which becomes payable within such prior taxable year but is income which becomes payable in the taxable year of the trust in which the date of distribution occurs. In any case, income becomes payable at a date not later than the date it is actually paid for the use of the distributee.

The application of section 162 (d) (2), in general, may be illustrated by the following examples:

Example (1). An existing trust makes its returns on the cash receipts and disbursements basis and on the basis of a calendar year accounting period. Under the terms of the trust and the local law (which allows accumulations) the income of the trust for the period of 12 months ended June 30 of each year is accumulated and the beneficiary has no right to such income until the last day of such period (June 30). For the purpose of the tax for 1941, the entire gross income received by the trust in 1941 is required to be included in its income for 1941, and, under the law applicable to 1941, the 1941 trust income distributable on June 30, 1941, is allowed as a deduction, but the 1941 trust income not distributable until June 30, 1942, is not allowable as a deduction for 1941. For the purpose of the tax for 1942, the entire gross income received by the trust in 1942 will be included in its income for 1942. Under section 162 (d) (2), the trust income for the 12 months ending June 30, 1942, which under the terms of the trust instrument, is available for distribution on such date, will be considered for the purposes of section 162 (b) as income for the taxable year 1942 which becomes payable on June 30, 1942, and, accordingly, will be deducted by the trust for 1942. Assuming the beneficiary makes his income tax returns on the calendar year basis, he will include this amount deducted by the trust in 1942 in his income for 1942. The same process will be repeated each year thereafter as long as the accounting periods and the distribution date remain the same. Thus, if, in such a case, the entire net income of the trust (determined before the application of section 162 (b)) is available for distribution and the trust receives each month $100 of such income available for distribution, for 1941 the trust will have $600 of taxable net income (before credits), that is, the excess of the $1,200 income over the $600 deduction for the June 30, 1941, distribution. For the taxable year ended December 31, 1942, the trust will include $1,200 in its income, which is its actual income for 1942 determined under section 161 without inclusion of that part of the 1941 income distributed on June 30, 1942, and without exclusion of that part of the 1942 income distributable on June 30, 1943. Assuming that the income distributable on June 30, 1942, is not to be reduced under the trust instrument and State law by the amount of tax paid by the trust with respect to the 1941 income included in such distribution, the trust will be allowed a deduction in computing its tax for 1942 of the whole $1,200 which becomes payable on June 30, 1942, and which is included in the beneficiary's income for 1942. Thus, for 1942 the trust will pay no income tax and the beneficiary will include $1,200 in computing his net income.

Example (2). An estate which came into being on January 1, 1941, accumulates the income received (as is allowed under the local law) until June 30, 1942, at which time the executor distributes $6,000 of income to the residuary legatee. The balance of the accumulated income becomes payable under the local law on December 31, 1942, the date the administration of the estate is terminated, and a final distribution of $18,000 of income is then made to the residuary legatee. It is established that the estate, which was on a cash basis, received net income, which it accumulated during the administration of the estate, at the rate of $1,000 a month, but in making the distributions to the residuary legatee the executor did not attempt to identify such distributions with the income received during any particular period during the administration of the estate. Upon such facts, for the taxable year 1942, the distribution on June 30, 1942, of $6,000 will be presumed to be a distribution out of the most recently accumulated income of the estate, that is, for the first six months of 1942, and the final distribution of $18,000 on December 31, 1942, will be considered a distribution out of the income for the entire period of administration, of which the last 12 months is the calendar year 1942 and the most recently accumulated income is the $6,000 for the last six months of 1942. Accordingly, for 1942 the estate will take a deduction of $12,000 and the legatee will include the same amount (out of the total of $24,000 received) in his income, by reason of the distributions on June 30 and December 31, 1942.

Example (3). Under the terms of the will of X, who died in 1940, after payment of expenses and specific bequests, the residue of his estate (which will include the undistributed income for the period of administration) is to be divided into two equal shares and one of such shares is to be paid over to his widow and the other such share is to be paid over to a testamentary trust for the benefit of his children. During the period of administration, the estate makes its returns on the calendar year basis. The administration of the estate is terminated on June 30, 1942, at which date equal shares of the principal and the income (which under the local law first became payable at such date) are transferred in accordance with the terms of the will to the widow and to a trust established as of such date. With the application of section 162 (d) (2) the widow and the trust will each include in their income tax returns filed for their first taxable years ending on or after June 30, 1942, one-half of the income of the estate for the 12 months preceding June 30, 1942. This distribution will include the income of the estate for the last six months of 1941 upon which the estate may already have paid tax for 1941, but such income may, if under the local law the Federal income tax is a charge against such income, be reduced by the amount of Federal income tax attributable to such income and paid for 1941 by the estate. The return of the estate for 1942 will show a deduction of the amount of the income for the 12 months preceding June 30, 1942, which is includible in the income of the widow and the testamentary trust.

The rule also applies in the case of a distribution out of income for a period which does not include any part of the current taxable year. Thus, in the case of a trust established on January 1, 1941, which accumulates the income in the first year of the trust and each year thereafter (more than 65 days after the close of the prior taxable year) distributes the prior year's accumulation, the 1941 accumulated income to be distributed in 1942 will be considered income of the trust for 1942 which is to be distributed in 1942.

If the prior period, the income of which becomes payable in the taxable year, is a period of more than 12 months, then only the income of the last 12 months of such period is considered to be income which is to be distributed during the cur-

rent taxable year. This rule may be illustrated by the following example:

Example. Under the terms of a testamentary trust, established in 1920, the income of the trust is to be accumulated until B, the beneficiary, reaches his twenty-first birthday, which is June 30, 1942, and then is to be distributed along with the corpus of the trust at such time as the trustee thereafter decides; the income of the trust after June 30, 1942, and until such time as the trustee decides to distribute the accumulated income and corpus to B is to be given to C. The returns of the trust are made on the calendar year basis. On December 31, 1942, the trustee decides to distribute to B, as of that date, the corpus and the income accumulated to June 30, 1942. Under section 162 (d) (2), the amount of accumulated income of the trust for the period July 1, 1941, through June 30, 1942 (the last 12 months of the period of accumulation), which becomes payable on December 31, 1942, is to be included in B's income. The amount of income of the trust for the period July 1, 1942, through December 31, 1942, is to be included in C's income. The trust will deduct such amounts under section 162 (b) in computing its taxable net income for 1942.

(c) *Distributions in first 65 days of taxable year.* Section 162 (d) (3) is designed to apportion amounts paid, credited, or to be distributed within the first 65 days of the taxable year of the estate or trust to that part of such first 65 days and the preceding taxable year to which such amounts are attributable.

Section 162 (d) (3) (B) applies in cases described in section 162 (d) (1), that is, generally, in cases of annuities. If an annuity becomes payable in the first 65 days of the taxable year of the estate or trust, a proportionate part of the amount which thus becomes payable is considered payable on the last day of the preceding year. This proportionate part is that part of the amount which becomes payable within the first 65 days as the part of the interval not falling within the taxable year bears to the whole period of the interval. If, however, the part of the interval not falling within the taxable year (the year in which the amount becomes payable) is a period of more than 12 months, the interval is considered to begin on a date 12 months before the end of the preceding taxable year. Thus, if $4,250 is to be paid every two years on March 1, the period of the interval ending March 1, 1943, is considered to begin 12 months preceding December 31, 1942 since the part of the interval not falling within the taxable year 1943 (March 2, 1941, through December 31, 1942) is more than 12 months. Accordingly, the interval is considered to be the period January 1, 1942, through March 1, 1943, or 425 days, and the part of the interval not falling within the taxable year is considered to be the calendar year 1942, or 365 days. Therefore, of the $4,250 which becomes payable on March 1, 1943, 365/425 of such amount, or $3,650, is considered to be an amount to be distributed on December 31, 1942. The provisions of section 162 (d) (1) determine the extent to which the amount distributed on March 1 and the amount considered to be distributed on December 31 are paid, credited, or to be distributed out of income of the estate or trust for its taxable year.

Section 162 (d) (3) (A) applies in the type of cases described in section 162 (d) (2) but only where income is paid, credited, or to be distributed within the first 65 days of the taxable year of the estate or trust. In such cases, if income of the estate or trust for a period beginning before the beginning of the taxable year becomes payable within the first 65 days of the taxable year, the income for the part of such period not falling within the taxable year is considered to be paid, credited, or distributed on the last day of the preceding taxable year. If the part of such period beginning before the beginning of the taxable year is more than 12 months, only the income of the last 12 months of such part is considered paid, credited (or to be distributed on the last day of the perceding taxable year. If the amount of income for any period paid, credited, or to be distributed to a legatee or beneficiary during the taxable year of the estate or trust is less than the total amount of income (not already paid, credited, or to be distributed to legatees or beneficiaries) for such period, such amount will be considered paid, credited, or to be distributed from the most recently accumulated income of the period. For example, a trust which makes its returns on the calendar year basis and which is to distribute the income of the trust, but not in excess of $5,000, to the beneficiary each February 28 received $500 of income each month during the period March 1, 1942, through February 28, 1943, or a total of $6,000. In such case, $1,000 of the $5,000 to be distributed to the beneficiairy on February 28, 1943, will be considered to be distributed out of the income of the trust for 1943 (the income of the period January 1, 1943, through February 28, 1943) and $4,000 will be considered to have been distributed to the beneficiary on December 31, 1942, out of the income of the trust for 1942.

Any amount paid, credited, or to be distributed within the first 65 days of any taxable year of the estate or trust beginning after December 31, 1941, and which is allocated under section 162 (d) (3) to the last day of a taxable year beginning before January 1, 1942, is not to be reflected in the returns of the estate or trust and of the legatee or beneficiary as a deduction or as income, as the case may be, for the taxable year in which such amount is actually paid, credited, or to be distributed.

SEC. 163. CREDITS AGAINST NET INCOME [as amended by sec. 126 (d), Rev. Act 1942].

(a) *Credits of estate or trust.* (1) For the purpose of the normal tax and the surtax an estate shall be allowed the same personal exemption as is allowed to a single person under section 25 (b) (1), and a trust shall be allowed (in lieu of the personal exemption under section 25 (b) (1)) a credit of $100 against net income.

(2) If no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then the estate or trust shall be allowed the same credits against net income for interest as are allowed by section 25 (a).

(b) *Credits of beneficiary.* If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary shall, for the purpose of the normal tax, be allowed as credits against net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of interest specified in section 25 (a) as are, under this Supplement, required to be included in computing his net income. Any remaining portion of such amounts specified in section 25 (a) shall, for the purpose of the normal tax, be allowed as credits to the estate or trust.

(c) *Credits of estate or trust and beneficiary in case of bond premium.* If the estate or trust elects under section 125 to treat the premium on bonds, the interest on which is allowable as a credit under section 25 (a) (1) or (2), as amortizable,

(1) For the purposes of subsection (a) (2), the credits allowed by section 25 (a) shall be reduced as provided in section 125 (a) (3);

(2) For the purposes of subsection (b), the proportionate share of the legatee, heir, or beneficiary of such interest shall be his proportionate share of such interest (determined without regard to this paragraph) reduced by so much of the deduction under section 23 (v) as is attributable to such share. The remainder of such deduction, for the purposes of the last sentence of subsection (b), shall be applied in reduction of such credits of the estate or trust.

§ 29.163–1 *Credits to estate, trust, or beneficiary*—(a) *Personal exemption allowed estates and trusts.* An estate is allowed for both normal tax and surtax purposes the personal exemption allowed a single person under section 25 (b) (1). For proration of the personal exemption in the case of a taxable year of less than 12 months, see §§ 29.25–7 and 29.47–1. A trust is allowed for both normal tax and surtax purposes a credit of $100 against net income. A credit for dependents is not allowable to an estate or trust.

(b) *Credit for interest to estate or trust.* If no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, the estate or trust shall be allowed the credits provided in section 25 (a), in respect of interest upon certain obligations of the United States. (For reduction of credits on account of amortizable bond premium, see § 29.125–9.)

(c) *Credit for interest to beneficiary.* If any part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, he is allowed for the purpose of the normal tax, in addition to his individual credits, the proportionate share of the interest upon obligations of the United States and instrumentalities of the United States which is exempt from normal tax only and is required to be included in computing net income. Any remaining portion of such interest will be allowed as a credit for the purpose of the normal tax to the estate or trust. Where the amount of the interest specified in section 25 (a) is in excess of the net income of the estate or trust, the proportionate share of such interest which each beneficiary is required to include in computing his net income and for which he is allowed a credit for normal tax purposes is an amount equal to his distributive share of the net income of the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income. (See section 25.) (For reduction of credits on account of amortizable bond premium, see § 29.125–9.)

SEC. 164. DIFFERENT TAXABLE YEARS [as amended by sec. 111 (d), Rev. Act 1942].

If the taxable year of a legatee, heir, or beneficiary is different from that of the estate or trust, the amount which he is required, under section 162 (b), to include in computing his net income, shall be based upon the income of the estate or trust for any taxable year of the estate or trust (whether beginning on, before, or after January 1, 1939) ending within or with his taxable year.

SEC. 111. INCOME RECEIVED FROM ESTATES, ETC., UNDER GIFTS, BEQUESTS, ETC. (Revenue Act of 1942, Title I.)

* * * * *

(e) *Taxable years to which amendments applicable.* The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1941; except that in the case of income paid, credited or to be distributed or amounts paid, credited or to be distributed by an estate or trust the amendments made by this section shall be applicable only with respect to such income and such amounts paid, credited or to be distributed on or after the beginning of the first taxable year of the estate or trust, as the case may be, beginning after December 31, 1941.

SEC. 165. EMPLOYEES' TRUSTS [as amended by sec. 218, Rev. Act 1939; sec. 162 (a), Rev. Act 1942].

(a) *Exemption from tax.* A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall not be taxable under this supplement and no other provision of this supplement shall apply with respect to such trust or to its beneficiary—

(1) if contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries;

(3) if the trust, or two or more trusts, or the trust or trusts and annuity plan or plans are designated by the employer as constituting parts of a plan intended to qualify under this subsection which benefits either—

(A) 70 per centum or more of all the employees, or 80 per centum or more of all the employees who are eligible to benefit under the plan if 70 per centum or more of all the employees are eligible to benefit under the plan, excluding in each case employees who have been employed not more than a minimum period prescribed by the plan, not exceeding five years, employees whose customary employment is for not more than twenty hours in any one week, and employees whose customary employment is for not more than five months in any calendar year, or

(B) such employees as qualify under a classification set up by the employer and found by the Commissioner not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees; and

(4) if the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

(5) A classification shall not be considered discriminatory within the meaning of paragraphs (3) (B) or (4) of this subsection merely because it excludes employees the whole of whose remuneration constitutes "wages" under section 1426 (a) (1) (relating to the Federal Insurance Contributions Act) or merely because it is limited to salaried or clerical employees. Neither shall a plan be considered discriminatory within the meaning of such provisions merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees, or merely because the contributions or benefits based on that part of an employee's remuneration which is excluded from "wages" by section 1426 (a) (1) differ from the contributions or benefits based on employee's remuneration not so excluded, or differ because of any retirement benefits created under State or Federal law.

(6) A plan shall be considered as meeting the requirements of paragraph (3) of this subsection during the whole of any taxable year of the plan if on one day in each quarter it satisfied such requirements.

(b) *Taxability of beneficiary.* The amount actually distributed or made available to any distributee by any such trust shall be taxable to him, in the year in which so distributed or made available, under section 22 (b) (2) as if it were an annuity the consideration for which is the amount contributed by the employee, except that if the total distributions payable with respect to any employee are paid to the distributee within one taxable year of the distributee on account of the employee's separation from the service, the amount of such distribution to the extent exceeding the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months.

(c) *Treatment of beneficiary of trust not exempt under subsection (a).* Contributions to a trust made by an employer during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is not exempt under section 165 (a) shall be included in the gross income of an employee for the taxable year in which the contribution is made to the trust in the case of an employee whose beneficial interest in such contribution is nonforfeitable at the time the contribution is made.

SEC. 162. PENSION TRUSTS. (Revenue Act of 1942, Title I.)

* * * * *

(d) *Taxable years to which amendments applicable.* The amendments made by this section shall be applicable as to both the employer and employees only with respect to taxable years of the employer beginning after December 31, 1941, except that—

(1) In the case of a stock bonus, pension, profit-sharing, or annuity plan in effect on or before September 1, 1942,

(A) such a plan shall not become subject to the requirements of section 165 (a) (3), (4), (5), and (6) until the beginning of the first taxable year beginning after December 31, 1942,

(B) such a plan shall be considered as satisfying the requirements of section 165 (a) (3), (4), (5), and (6) for the period beginning with the beginning of the first taxable year following December 31, 1942, and ending December 31, 1943, if the plan satisfies such requirements by December 31, 1943,

* * * * *

(2) In the case of a stock bonus, pension, profit sharing or annuity plan put into effect after September 1, 1942, such a plan shall be considered as satisfying the requirements of section 165 (a) (3), (4), (5) and (6) for the period beginning with the date such plan is put into effect and ending December 31, 1943, if the plan satisfies such requirements by December 31, 1943.

§ 29.165–1 *Employees' trusts*—(a) *In general.* In order that a trust may be exempt under section 165 (a) it must be part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries. The trust must be formed and availed of solely to aid in the proper execution of a plan which is a definite written program and arrangement communicated to the employees, solely designed and applied to enable such employees or their beneficiaries to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees or their beneficiaries after the retirement of such employees.

The term "plan" implies a permanent as distinguished from a temporary program. While the employer may reserve the right to change or terminate the plan, and to discontinue contributions thereunder, if the plan is abandoned for any cause other than business necessity within a few years after it has taken effect, this will be evidence that the plan from its inception was not a bona fide program for the exclusive benefit of employees in general. Especially will this be true in the case of a pension plan under which pensions were fully funded for the highly paid employees or others in favor of whom discrimination is prohibited under section 165 (a), and which was abandoned soon after the pensions for such favored employees had been provided. The permanency of the plan will be indicated by all of the surrounding facts and circumstances, including the likelihood of the employer's ability to continue contributions as provided under the plan. In the event a plan is abandoned, the employer should promptly notify the Commissioner, stating the circumstances which led to the discontinuance of the plan.

If the plan is so designed as to amount to a subterfuge for the distribution of profits to shareholders, even if other employees who are not shareholders are included under the plan, it will not qualify as a plan for the exclusive benefit of employees. The plan must benefit the employees in general, although it need not provide benefits for all of the employees. Among the employees to be benefited may be persons who are officers and shareholders. However, a plan is not for the exclusive benefit of employees in general if it discriminates either in eligibility requirements, contributions, or benefits by any device whatever in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees. See section 165 (a) (3), (4), and (5). All of the surrounding and attendant circumstances and the details of the plan will be indicative of whether it is a bona fide stock bonus, pension, or profit-sharing plan for the exclusive benefit of employees in general. The law is concerned not so much with the form of any plan as it is with its effects in operation. For example, in section 165 (a) (5) the law specifies certain provisions, which of themselves are not discriminatory, but this does not mean that a plan containing these provisions may not be discriminatory in actual operation.

A plan is for the exclusive benefit of employees or their beneficiaries even though it may cover former employees as well as present employees and employees who are temporarily on leave, as, for example, in the military or naval forces. A plan covering only former employees may qualify under section 165 (a) if it complies with the provisions of section 165 (a) (3) (B), with respect to coverage, and section 165 (a) (4), with respect to contributions and benefits, as applied to all of the former employees. The term "beneficiaries" of an employee within the meaning of section 165 includes the estate of the employee, dependents of the employee, persons who are the natural objects of the employee's bounty, and any persons designated by the employee to share in the benefits of the plan after the death of the employee.

No specific limitations are provided in section 165 (a) with respect to investments which may be made by the trustees of a trust qualifying under section 165 (a). The contributions may be used by the trustees to purchase any investments permitted by the trust agreement, to the extent allowed by local law. Where, however, the trust funds are invested in stock or securities of the employer, full disclosure must be made of the reasons for such arrangement and of the conditions under which such investments are made in order that the Commissioner may determine whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees.

(b) *Portions of years; affiliated corporations.* An exempt status must be maintained throughout the entire taxable year of the trust in order for the trust to obtain any exemption for such year. But see section 165 (a) (6) and § 29.165–3. A trust forming part of a plan of affiliated corporations for their employees may be exempt if all the requirements are otherwise satisfied.

(c) *Proof of exemption.* Every trust claiming exemption must prove its right thereto by filing with the collector of the district in which the employer files his return: (1) An affidavit showing its character, purpose, activities, sources and disposition of corpus and income, and every fact which might affect its status for exemption; (2) verified copies of the trust instrument and of the employer's plan, showing all amendments; (3) the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the trust; and (4) the information required under § 29.23(p)–2 in order to show that the trust forms part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries, which plan meets the requirements of section 165 (a).

The collector upon receipt of the affidavit and other papers will forward them to the Commissioner for decision as to whether the trust is exempt. The information required in the preceding paragraph must be filed for each taxable year of the trust with respect to which this section is applicable, but the documents or information mentioned in (1) and (2) of paragraph (c) need not be filed with respect to other than the first of such taxable years, except when necessary to show changes occurring since the last filing.

§ 29.165–2 *Impossibility of diversion under the trust instrument*—(a) *In general.* Under section 165 (a) (2) a trust is not exempt unless under the trust instrument it is impossible (in the taxable year and at any time thereafter prior to the satisfaction of all liabilities to employees or their beneficiaries covered by the trust) for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of such employees or their beneficiaries. As used in section 165 (a) (2), the phrase "if under the trust instrument it is impossible" means that the trust instrument must definitely and affirmatively make it impossible for the nonexempt diversion or use to occur, whether by operation or natural termination of the trust, by power of revocation or amendment, by the happening of a contingency, by collateral arrangement, or by any other means. It is not essential that the employer relinquish all power to modify or terminate the rights of certain employees covered by the trust, but it must be impossible for the trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees or their beneficiaries. As used in section 165 (a) (2), the phrase "purposes other than for the exclusive benefit of his employees or their beneficiaries" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust.

(b) *Meaning of "liabilities."* The intent and purpose in section 165 (a) (2) of the phrase "prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust" is to permit the employer to reserve the right to recover at the termination of the trust, and only at such termination, such balance in the trust as is due to erroneous actuarial computations during the previous life of the trust. A balance due to an "erroneous actuarial computation" is the surplus arising because actual requirements differ from the expected requirements based upon previous actuarial valuations of liabilities or determinations of costs of providing pension benefits under the plan in accordance with reasonable assumptions as to mortality, interest, etc., and correct procedures relating to the method of funding, all as made by a careful person skilled in calculating the amounts necessary to satisfy pecuniary obligations of such a nature. For example, a trust has accumulated assets of $1,000,000 at the time of liquidation, determined by acceptable actuarial procedures using reasonable assumptions as to interest, mortality, etc., as being necessary to provide the benefits in accordance with the provisions of the plan. Upon such liquidation it is found that $950,000 will satisfy all of the liabilities under the plan. The surplus of $50,000 arises, therefore, because of the difference between the amounts actuarially determined and the amounts actually required to satisfy the liabilities. This $50,000, therefore, is the amount which may be returned to the employer as the result of an erroneous actuarial computation. If, however, the surplus of $50,000 had been accumulated as a result of a change in the benefit provisions or in the eligibility requirements of the plan, the $50,000 could not revert to the employer because such surplus would not be the result of an erroneous actuarial calculation. The term "liabilities" as used in section 165 (a) (2) includes both fixed and contingent obligations to employees. For example, if 1,000 employees are covered by a trust forming part of a pension plan, 300 of whom have satisfied all the requirements for a monthly pension, while the remaining 700 employees have not yet completed the required period of service, contingent obligations to such 700 employees have nevertheless arisen which constitute "liabilities" within the meaning of that term. It must be impossible for the employer (or other nonemployee) to recover any amounts other than such amounts as remain in the trust because of "erroneous actuarial computations" after the satisfaction of all fixed and contingent obligations, and the trust instrument must contain a definite affirmative provision to that effect, whether the obligations to employees have their source in the trust instrument itself, in the plan of which the trust forms a part, or in some collateral instrument or arrangement forming a part of such plan, and whether such obligations are, technically speaking, liabilities of the employer, of the trust, or of some other person forming a part of the plan or connected with it.

§ 29.165–3 *Requirements as to coverage.* In order to insure that stock bonus, pension, and profit-sharing plans are utilized for the welfare of employees in general, and to prevent the trust device from being used for the principal benefit of shareholders, officers, persons whose principal duties consist in supervising the work of other employees, or highly paid employees, or as a means of tax avoidance, a trust will not be exempt unless it is part of a plan which satisfies the coverage requirements of section 165 (a) (3). See § 26.165–5 as to the effective date of section 165 (a) (3). The percentage requirements in section 165 (a) (3) (A) refer to a percentage of all the active employees, including employees temporarily on leave, such as those in the armed forces of the United States, if such employees are eligible under the plan. The application of section 165 (a) (3) (A) may be illustrated by the following example:

Example. An employer adopts a plan at a time when he has 1,000 employees. The plan provides that all full-time employees who have been in the employment for a period of two years and have reached the age of 30 shall be eligible to participate. The plan also requires the participating employees to agree to contribute 3 percent of their monthly pay. At the time the plan is made effective 100 of the 1,000 employees had not been in the employment for a period of two years.

Fifty of the employees were seasonal employees whose customary employment was for not more than five months in any calendar year. Twenty-five of the employees were part-time employees whose customary employment was for not more than 20 hours in any one week. One hundred and fifty of the full-time employees who had been employed for two years or more had not yet reached age 30.

Section 165 (a) (3) (A) will be met if 540 employees are covered by the plan, as shown by the following computation:

1. Total employees with respect to which the percentage requirements are applicable (1,000 minus (100 plus 50 plus 25))	825
2. Employees not eligible to participate because of age requirements	150
3. Total employees eligible to participate	675
4. Percentage of employees in item 1 eligible to participate	.81+
5. Minimum number of participating employees to qualify the plan (80 percent of 675)	540

If only 70 percent, or 578, of the 825 employees satisfied the age and service requirements, then 462 (80 percent of 578) participating employees would satisfy the percentage requirements.

If a plan fails to qualify under the percentage requirements of section 165 (a) (3) (A), it may still qualify under subparagraph (B) of such section provided always that (as required by paragraphs (3) and (4) of section 165 (a)) the plan's eligibility conditions, benefits, and contributions do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees.

Section 165 (a) (5) sets out certain classifications that will not in themselves be considered discriminatory. However, those so designated are not intended to be exclusive. Thus, plans may qualify under section 165 (a) (3) (B) which are limited to employees who have reached a designated age or have been in the employment for a designated number of years or are employed in certain designated departments or are in other classifications: *Provided*, That the effect of covering only such employees is not to discriminate in favor of officers, shareholders, employees whose principal duties consist in supervising the work of other employees, or highly compensated employees. For example, if there are 1,000 employees, and the plan is written for only salaried employees, and consequently only 500 employees are covered, that fact alone will not justify the conclusion that the plan does not meet the coverage requirement of section 165 (a) (3) (B), provided the classification as established does not discriminate in favor of shareholders, officers, employees whose principal duties consist in supervising the work of other employees, and the highly paid employees. If a contributory plan is offered to all of the employees, but the requirement of contribution by the employee participants is so burdensome as to make the plan acceptable only to the highly paid employees, the classification will be considered discriminatory in favor of such highly paid employees.

Section 165 (a) (5) contains a provision to the effect that a classification shall not be considered discriminatory within the meaning of subparagraph (B) merely because there are excluded from the plan employees whose annual remuneration is $3,000 or less and as to which the Social Security Act applies. This provision, in conjunction with subparagraph (B), is intended to permit plans to qualify which supplement the social security program. A classification which excludes all employees the whole of whose remuneration constitutes wages under section 1426 (a) (1) (relating to the Federal Insurance Contributions Act), or a classification including such employees in a plan under which the contributions or benefits based on that part of an employee's remuneration which is excluded from wages under such law differs from the contributions or benefits based on the employee's remuneration not so excluded, will not be a discriminatory classification merely because of such exclusion or difference. However, in making his determination with respect to discrimination in classification under section 165 (a) (3) (B) the Commissioner will consider whether the total benefits resulting to each employee under the plan and under such law or under such law only establish an integrated and correlated retirement system satisfying the tests of section 165 (a). Thus, a classification of employees under any plan which results in relatively or proportionately greater benefits for employees earning above any specified salary amount or rate than for those below such salary amount or rate may be found to be discriminatory within the meaning of subparagraph (B) unless such relative or proportionate differences in benefits as between employees resulting from such classification are approximately offset by the retirement benefits provided by the Social Security Act. For this purpose the total Social Security Act benefits of an employee, in view of the supplementary benefits provided by such law, may be considered as 150 percent of the primary insurance benefit provided thereby. A plan supplementing the Social Security Act and excluding employees earning $3,000 per annum or less will not, however, be deemed discriminatory merely because, for administrative convenience, it provides a reasonable minimum benefit not to exceed $20 a month. Similar considerations, to the extent applicable in any case, will govern classifications under plans supplementing the benefits provided by other Federal or State laws. See section 165 (a) (5).

An employer may designate several trusts or a trust or trusts and an annuity plan or plans as constituting one plan which is intended to qualify under section 165 (a) (3), in which case all of such trusts and plans taken as a whole may meet the requirements of such section. The fact that such combination of trusts and plans fails to qualify as one plan does not prevent such of the trusts and plans as qualify from meeting the requirements of section 165 (a).

It is provided in section 165 (a) (6) that a plan will satisfy the requirements of section 165 (a) (3), if on at least one day in each quarter of the taxable year of the plan it satisfies such requirements. This makes it possible for a new plan requiring contributions from employees to qualify if by the end of the quarter-year in which the plan is adopted it secures sufficient contributing participants to meet the requirements of section 165 (a) (3). It also affords a period of time in which new participants may be secured to replace former participants, so as to meet the requirements of either subparagraph (A) or (B) of section 165 (a) (3).

§ 29.165–4 *Discrimination as to contributions or benefits.* To be exempt under section 165 (a) a trust must not only meet the coverage requirements of section 165 (a) (3), but, as provided in section 165 (a) (4), it must also be part of a plan under which there is no discrimination in contributions or benefits in favor of officers, shareholders, employees whose principal duties consist in supervising the work of other employees, or highly compensated employees as against other employees whether within or without the plan. However, section 165 (a) (5) sets out certain provisions which will not in and of themselves be discriminatory within the meaning of section 165 (a) (3) or (4). (See § 29.165–3.) Thus, a plan will not be considered discriminatory merely because the contributions or benefits bear a uniform relationship to total compensation, or to the basic or regular rate of compensation, or merely because the contributions or benefits based on the first $3,000 of annual compensation of employees subject to the Federal Insurance Contributions Act differ from the contributions or benefits based on the excess of such annual compensation over $3,000. The exceptions specified in section 165 (a) (5) are not an exclusive enumeration, but a recital of provisions frequently encountered which will not of themselves constitute forbidden discrimination in contributions or benefits. Variations in contributions or benefits may be provided so long as the plan, viewed as a whole for the benefit of employees in general, with all its attendant circumstances, does not discriminate in favor of employees within the enumerations with respect to which discrimination is prohibited.

A plan which excludes employees, the whole of whose remuneration constitutes wages under section 1426 (a) (1), (relating to the Federal Insurance Contributions Act), or a plan in which the contributions or benefits based on that part of an employee's remuneration which is excluded from wages under such law differs from contributions or benefits based on the employee's remuneration not so excluded, or a plan in which the contributions or benefits differ because of any retirement benefit created under State or Federal law, will not be discriminatory because of such exclusion or difference, provided the total benefits resulting under the plan and under such law establish an integrated and correlated retirement system satisfying the tests of section 165 (a).

Although a plan may provide for termination at will by the employer, this will not of itself prevent a trust from qualifying as exempt under section 165 (a). However, in certain cases that fact may necessitate some provision in the plan which will preclude such termination from effecting the prohibited discriminations. This may occur where, for example, certain officers or highly compensated employees are at the inception of the plan within a few years of retirement age and the operation of the plan will fund and vest their benefits in a short period, thus resulting in such discrimination in favor of such officers or highly compensated employees.

§ 29.165–5 *Effect of amendments to section 165 (a) on old and new stock bonus, pension, profit-sharing, and annuity plans.* Section 162 (d) of the Revenue Act of 1942 (set forth immediately preceding § 29.165–1) makes the requirements of section 165 (a) (3), (4), (5), and (6) inapplicable for taxable years beginning prior to January 1, 1943, in the case of a stock bonus, pension, profit-sharing, or annuity plan in effect on or before September 1, 1942. In such cases, for such taxable years a trust will be exempt if it complies with section 165 (a) (1) and (2), except that for taxable years beginning prior to January 1, 1940, it need not comply with section 165 (a) (2). The provisions of § 19.165–1 of this chapter are applicable in such a case to a taxable year beginning after December 31, 1941, and prior to January 1, 1943. A plan which requires the use of a trust is not in effect as of September 1, 1942, if there was no valid trust in existence at that time. A plan requiring the purchase of an annuity or insurance contract or contracts is not in effect as of September 1, 1942, if there is no such contract or contracts in effect at that time.

In the case of a plan in effect on or before September 1, 1942, the plan will be considered as satisfying the requirements of section 165 (a) (3), (4), (5), and (6) for the period beginning with the beginning of the first taxable year following December 31, 1942, and ending December 31, 1943, if the plan satisfies such requirements by December 31, 1943. Thus, if an employer having such a plan in effect makes a return on the basis of the calendar year, he will have until December 31, 1943, to amend his plan so as to make it satisfy such requirements for the calendar year 1943. Also, if he is on a fiscal year basis he will have until December 31, 1943, to amend his plan with respect to a taxable year beginning after December 31, 1942.

In the case of plans not in effect on or before September 1, 1942, section 165 is applicable to all taxable years beginning after December 31, 1941. However, if such a plan satisfies the requirements of section 165 (a) (3), (4), (5), and (6) by December 31, 1943, it shall be considered as satisfying such requirements for the period beginning with the date such plan is put into effect and ending December 31, 1943.

§ 29.165–6 *Taxability of beneficiary under a trust which meets the requirements of section 165 (a).* Section 165 (b) and (c) relates to the taxation of the beneficiary of an employees' trust. If an employer makes a contribution for the benefit of an employee to a trust for the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 165 (a), the employee is not required to include such contributions in his income except in the year or years in which such contributions are distributed or made available to him. It is immaterial in the case of contributions to an exempt trust whether the employee's rights in the contributions to the trust are forfeitable or nonforfeitable either at the time the contribution is made to the trust or thereafter. The distribution from such an exempt trust when received or made available will be taxable to him as if it were an annuity to the extent provided in section 22 (b) (2). The provisions of section 165 (b) relate only to distributions by a trust which is exempt under section 165 (a) for the taxable year of the trust in which the distribution is made. If a trust is exempt for the taxable year in which the distribution occurs but was not so exempt for one or more prior taxable years, the amount of any such taxable distribution may be reduced by the part thereof shown to the satisfaction of the Commissioner to be properly allocable to employer's contributions or earnings of the trust previously accounted for as taxable income by the employee or to earnings of the trust previously accounted for as taxable income by the trust. Where the distribution occurs in a taxable year of the trust for which it is not exempt under section 165 (a), the taxability of such distribution will depend on the taxable status of the trust under other provisions of the Internal Revenue Code at the time of the distribution. If such trust was not exempt for one or more prior taxable years, the adjustments outlined above may be made in connection with any distribution.

If a trust exempt under section 165 (a) purchases an annuity contract for an employee and distributes it to the employee in a year for which the trust is exempt, the contract containing a cash surrender value which may be available to an employee by surrendering the contract, such cash surrender value will not be considered income to the employee unless and until the contract is surrendered.

If pension or annuity payments are continued after the death of a retired employee to his beneficiary, such beneficiary will be required to include such pension or annuity payments in income to the same extent that the deceased employee would have been required to include such payments in income had he lived to receive such payments. See also section 126 (a). If the trust purchases under the plan retirement income insurance with life insurance protection payable upon the death of the employee participants, so much of the premiums as was paid from the contributions of the employer or earnings thereon for such life insurance protection will constitute income to the employee for the year or years in which the contributions or earnings are applied to the purchase of such life insurance. If the amount payable upon death at any time during the year exceeds the cash value (or if no cash value, then the reserve) of the insurance policy at the end of the year, the entire amount of such excess will be considered current life insurance protection. The cost of such insurance will be considered to be the 1-year term premium for such amount based upon the rates of the company issuing the annuity contract (or if no 1-year term policy is issued, the cost of such 1-year term computed by using the same mortality table and rate of interest and rate of loading as was used in determining the rates for the annuity contract). The determination of the cost of life insurance protection may be illustrated by the following example:

Example: A policy is purchased by an employer for an employee 35 years of age, providing an annuity of $100 per month upon retirement at age 65, with a minimum death benefit of $10,000. The level annual premium for the policy is $436.40. The insurance payable if death occurred in the first year would be $10,000. The cash value at the end of the first year is 0. The net insurance is therefore $10,000 minus 0, or $10,000. Assuming that the 1-year term premium for the same insurance company is $12.15 per $1,000, the premium for $10,000 of life insurance is therefore $121.50, and this is the amount to be reported as income by the employee for the year. The balance of $314.90 is the amount contributed for the annuity, which is not taxable to the employee under a plan meeting the requirements of section 165 (a), except as provided under section 165 (b). Assuming that the cash value at the end of the second year is $480, the net insurance would then be $9,520 for the second year. With a 1-year term rate of $12.33 (age 36), the amount to be reported as income to the employee would be $117.38. Any amounts paid under an annuity contract as a death benefit, not in the nature of life insurance, shall be included in the income of the beneficiary when received, and is not excluded from income under section 22 (b) (1).

If the total distributions payable with respect to any employee under a trust that in the year of distribution is exempt under section 165 (a) are paid to the distributee within one taxable year of the distributee on account of the employee's separation from the service, the amount of such distribution, to the extent it exceeds the amount contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months. For example, if, under a profit-sharing trust, the total distributions to which an employee is entitled are paid in a taxable year of the trust for which it is exempt to the employee in the year in which he retires or severs his connection with his employer, or to his widow if he dies during the course of his employment, the amount received by the employee or widow to the extent it exceeds the employee's contributions will be considered a gain from the sale or exchange of a capital asset held for more than six months, to be taken into account to the extent provided in section 117 (b). As to adjustments if the trust was not exempt for one or more taxable years prior to the year of distribution, see the first paragraph of this section.

§ 29.165–7 *Treatment of beneficiary of a trust not exempt under section 165 (a).* Any contribution made by an employer on behalf of an employee to a trust during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is not exempt under section 165 (a), shall be included in income of the employee for his taxable year during which the contribution is made if the employee's beneficial interest in the contribution is nonforfeitable at the time the contribution is made. An employee's beneficial interest in the contribution is nonforfeitable within the meaning of sections 165 (c) and 23 (p) (1) (D) at the time the contribution is made if there is no contingency under the plan which may cause the employee to lose his rights in the contribution. For example, if under the terms of a pension plan, an employee upon termination of his services prior to the retirement date, whether voluntarily or involuntarily, is entitled to a deferred annuity contract to be purchased with the employer's contributions made on his behalf, or is entitled to annuity payments which the trustee is obligated to make under the terms of the trust instrument based on the contributions made by the employer on his behalf, the employee's beneficial interest in such contributions is nonforfeitable. On the other hand, if, under the terms of a pension plan, an employee will lose the right to any annuity purchased from, or to be provided by, contributions made by the employer if his services should be terminated prior to retirement, his beneficial interest in such contributions is forfeitable. The mere fact that an employee may not live to the retirement date, or may live only a short period after the retirement date, and may not be able to enjoy the receipt of annuity or pension payments, does not make his beneficial interest in the contributions made by the employer on his behalf forfeitable. If the employer's contributions have been irrevocably applied to purchase an annuity contract for the employee, or if the trustee is obligated to use the employee's contributions to provide an annuity for the employee provided only that the employee is alive on the dates the annuity payments are due, the employee's rights in the employer's contributions are nonforfeitable.

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

§ 29.166–1 *Trusts with respect to the corpus of which the grantor is regarded as remaining in substance the owner—* (a) *Scope.* If the grantor of a trust is regarded, within the meaning of the Internal Revenue Code, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor, except as provided in sections 22 (k) and 171. This section deals with the taxation of such income. As used in this section, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) *Test of taxability to grantor.* Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this section the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. A bare legal interest, such as that of a trustee, is never substantial and never adverse. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor (except as provided in section 22 (k) or 171) regardless of:

(1) Whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend, or to appoint;

(2) Whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) The time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) Whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both;

(5) When the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Internal Revenue Code, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Internal Revenue Code has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: The fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstance bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus, the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

Example. A grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) For the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) For the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) For the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or

amendment thereof, resulting in the designation of the grantor as distributee.

If, however, the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

(c) *Income and deductions.* If the grantor is regarded as remaining in substance the owner of the corpus, except as provided in sections 22 (k), 23 (u), and 171, the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

§ 29.167–1 *Trusts in the income of which the grantor retains an interest*—(a) *Scope.* Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the corpus of the trust (as in section 166), but because of his retention of a certain interest in the income of the trust. This section deals with the taxation of such income. The term "income", as used in this section, means any part or the whole of the income of the trust.

(b) *Test of taxability to the grantor.* The test prescribed by the Internal Revenue Code as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another (except a wife to whom such income is taxable under section 22 (k) or 171) in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this section, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right so to effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor. A bare legal interest, such as that of a trustee, is never substantial and never adverse.

If the grantor has retained any such interest in the income, such income is taxable to the grantor (except as provided in section 22 (k) or 171) regardless of:

(1) Whether it may be distributed currently or accumulated for future distribution;

(2) Whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) Whether, if such distribution is in any way affected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both;

(4) The time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) When the trust was created.

Thus, the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Internal Revenue Code, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor, except where it is expressly required by section 22 (k) or 171 to be included in the gross income of a wife or a former wife.

If the grantor strips himself permanently and definitely of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(c) *Income and deductions.* If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled to had such income been distributable currently to him.

SEC. 168. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as credit against the tax the beneficiary of an estate or trust to the extent provided in section 131.

SEC. 169. COMMON TRUST FUNDS [as amended by secs. 126 (e), 150 (f), Rev. Act 1942].

(a) *Definitions.* The term "common trust fund" means a fund maintained by a bank (as defined in section 104)—

(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and

(2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks.

(b) *Taxation of common trust funds.* A common trust fund shall not be subject to taxation under this chapter, subchapters A or B of chapter 2, or section 105 or 106 of the Revenue Act of 1935, 49 Stat. 1017, 1019, or chapter 6 and for the purposes of such chapters and subchapters shall not be considered a corporation.

(c) *Income of participants in fund*—(1) *Inclusions in net income.* Each participant in the common trust fund in computing its net income shall include, whether or not distributed and whether or not distributable—

(A) As part of its gains and losses from sales or exchanges of capital assets held for not more than 6 months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for not more than 6 months.

(B) As part of its gains and losses from sales or exchanges of capital assets held for more than 6 months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for more than 6 months.

(C) Its proportionate share of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in subsection (d).

(2) *Credit for partially exempt interest.* The proportionate share of each participant in the amount of interest specified in section 25 (a) received by the common trust fund shall for the purposes of this Supplement be considered as having been received by such participant as such interest. If the common trust fund elects under section 125 to treat the premium on bonds, the interest on which is allowable as a credit under section 25 (a) (1) or (2), as amortizable, for the purposes of the preceding sentence the proportionate

share of the participant of such interest received by the common trust fund shall be his proportion share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 23 (v) as is attributable to such share.

(d) *Computation of common trust fund income.* The net income of the common trust fund shall be computed in the same manner and on the same basis as in the case of an individual except that—

(1) There shall be segregated the gains and losses from sales or exchanges of capital assets;

(2) After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income;

(3) The so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed.

(e) *Admission and withdrawal.* No gain or loss shall be realized by the common trust fund by the admission or withdrawal of a participant. The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of such interest by the participant.

(f) *Returns by bank.* Every bank (as defined in section 104) maintaining a common trust fund shall make a return under oath for each taxable year, stating specifically, with respect to such fund, the items of gross income and the deductions allowed by this chapter, and shall include in the return the names and addresses of the participants who would be entitled to share in the net income if distributed and the amount of the proportionate share of each participant. The return shall be sworn to as in the case of a return filed by the bank under section 52.

(g) *Different taxable years of common trust fund and participant.* If the taxable year of the common trust fund is different from that of a participant, the inclusions with respect to the net income of the common trust fund, in computing the net income of the participant for its taxable year shall be based upon the net income of the common trust fund for any taxable year of the common trust fund (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the participant.

§ 29.169–1 *Common trust fund defined.* Under section 169 two conditions must be satisfied by a fund maintained by a bank (as defined in section 104) before such fund may be designated as a "common trust fund." These conditions are that such fund must be maintained by such a bank:

(a) Exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank, whether acting alone or in conjunction with one or more co-fiduciaries, but solely in its capacity: (1) as a trustee of a trust created by will, deed, agreement, declaration of trust, or order of court, (2) as an executor of the will of, or as an administrator of the estate of, a deceased person, or (3) as a guardian (by whatever name known under local law) of the estate of an infant, of an incompetent individual or of an absent individual; and

(b) In conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks, whether or not the bank maintaining such fund is a national bank or a member of the Federal Reserve System.

Except as otherwise provided in this section and §§ 29.169–2 to 29.169–5, inclusive, the term "participant" refers to any trust or estate, the moneys of which have been contributed to the common trust fund.

§ 29.169–2 *Income of participants in common trust fund.* (a) Each participant in a common trust fund is required to include in computing its net income for its taxable year within which or with which the taxable year of the fund ends, whether or not distributed and whether or not distributable:

(1) Its proportionate share of the gains and losses from sales or exchanges of capital assets held for not more than six months, computed as provided in § 29.169–3, as part of its gains and losses from sales or exchanges of capital assets held for not more than six months.

(2) Its proportionate share of the gains and losses from sales or exchanges of capital assets held for more than six months, computed as provided in § 29.169–3, as part of its gains and losses from sales or exchanges of capital assets held for more than six months.

(3) Its proportionate share of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in § 29.169–3.

(b) Each participant's proportionate share in the amount of interest specified in section 25 (a) received by the common trust fund shall be deemed to have been received by such participant as such interest. (For reduction of credit for such interest on account of amortizable bond premium, see § 29.125–9.) For the purposes of the Internal Revenue Code, any tax withheld at the source from income of the fund shall be deemed to have been withheld proportionately from the participants to whom such income is allocated.

(c) The proportionate share of each participant in the gains and losses from sales or exchanges of capital assets held for not more than six months, gains and losses from sales or exchanges of capital assets held for more than six months, the ordinary net income or ordinary net loss, the partially exempt interest, and the tax withheld at the source shall be determined in accordance with the method of accounting adopted by the bank in accordance with the written plan under which the common trust fund is established and administered, provided such method clearly reflects the income of each participant.

The items of income and deductions are, therefore, to be allocated to the periods between valuation dates within the taxable year established by such plan in which they were realized or sustained, and the ordinary net income or ordinary net loss, gains and losses from sales or exchanges of capital assets held for not more than six months, and gains and losses from sales or exchanges of capital assets held for more than six months computed for each such period. The proportionate shares of the participants in such items are then to be determined. The provisions of this paragraph may be illustrated by the following example:

Example. The plan of a common trust fund provides for quarterly valuation dates and for the computation and the distribution of the income upon a quarterly basis, except that there shall be no distribution of capital gains. The participants are as follows: Trusts A, B, C, and D for the first quarter; Trusts A, B, C, and E for the second quarter; and Trusts A, B, F, and G for the third and fourth quarters, the participants having equal participating interests. As computed upon the quarterly basis, the ordinary net income, the short-term capital gain, and the long-term capital loss for the taxable year were as follows:

	First quarter	Second quarter	Third quarter	Fourth quarter	Total
Ordinary net income	$200	$300	$200	$400	$1,100
Short-term capital gain	200	100	200	100	600
Long-term capital loss	100	200	100	200	600

The participants' shares of ordinary net income are as follows:

PARTICIPANTS' SHARES OF ORDINARY NET INCOME

Participant	First quarter	Second quarter	Third quarter	Fourth quarter	Total
A	$50	$75	$50	$100	$275
B	50	75	50	100	275
C	50	75	-------	-------	125
D	50	-------	-------	-------	50
E	-------	75	-------	-------	75
F	-------	-------	50	100	150
G	-------	-------	50	100	150
Total	200	300	200	400	1,100

The participants' shares of the short-term capital gain are as follows:

PARTICIPANTS' SHARES OF SHORT-TERM CAPITAL GAIN

Participant	First quarter	Second quarter	Third quarter	Fourth quarter	Total
A	$50	$25	$50	$25	$150
B	50	25	50	25	150
C	50	25	-------	-------	75
D	50	-------	-------	-------	50
E	-------	25	-------	-------	25
F	-------	-------	50	25	75
G	-------	-------	50	25	75
Total	200	100	200	100	600

The participants' shares of the long-term capital loss are as follows:

PARTICIPANTS' SHARES OF LONG-TERM CAPITAL LOSS

Participant	First quarter	Second quarter	Third quarter	Fourth quarter	Total
A	$25	$50	$25	$50	$150
B	25	50	25	50	150
C	25	50	-------	-------	75
D	25	-------	-------	-------	25
E	-------	50	-------	-------	50
F	-------	-------	25	50	75
G	-------	-------	25	50	75
Total	100	200	100	200	600

If in the above example the common trust fund also had short-term capital losses and long-term capital gains, the treatment of such gains or losses would be similar to that accorded to the short-term capital gains and long-term capital losses in the above example.

(d) The provisions of sections 161, 162, 166, and 167 are applicable in deter-

mining the extent to which each participant's proportionate share of the income of the common trust fund is taxable to the participant, or to the beneficiaries or the grantor of the participant.

§ 29.169–3 *Computation of common trust fund income.* The net income of the common trust fund shall be computed in the same manner and on the same basis as in the case of an individual, except that:

(a) No deduction shall be allowed under section 23 (o) for charitable contributions.

(b) The gains and losses from sales or exchanges of capital assets of the common trust fund are required to be segregated. A common trust fund is not allowed the benefit of the capital loss carry-over provided by section 117 (e).

(c) The ordinary net income, that is, the excess of the gross income over the deductions, or the ordinary net loss, that is, the excess of the deductions over the gross income, shall be computed after excluding gains and losses from sales or exchanges of capital assets.

§ 29.169–4 *Admission and withdrawal of participants from the common trust fund*—(a) *Gain or loss.* The common trust fund realizes no gain or loss by the admission or withdrawal of a participant, and the basis of the assets and the period for which they are deemed to have been held by the common trust fund for the purposes of section 117 (b) are unaffected by such an admission or withdrawal. If a participant withdraws the whole or any part of its participating interest from the common trust fund, such withdrawal shall be treated as a sale or exchange by the participant of the participating interest or portion thereof which is so withdrawn. A participant is not deemed to have withdrawn any part of its participating interest in the common trust fund so as to have completed a closed transaction by reason of the segregation and administration of an investment of the fund, pursuant to the provisions of subdivision (c) (7) of section 17 of Regulation F of the Board of Governors of the Federal Reserve System, effective December 31, 1937, for the benefit of all the then participants in the common trust fund. Such segregated investment shall be considered as held by, or on behalf of, the common trust fund for the benefit ratably of all participants in the common trust fund at the time of segregation, and any income or loss arising from its administration and liquidation shall constitute income or loss to the common trust fund apportionable among the participants for whose benefit the investment was segregated.

(b) *Basis for gain or loss upon withdrawal.* The participant's gain or loss upon withdrawal of its participating interest or portion thereof shall be measured by the difference between the amount received upon such withdrawal and the basis of the participating interest or portion thereof withdrawn (with proper adjustments as provided in section 113 (b) to the date of withdrawal) plus the additions prescribed in paragraph (c) of this section and minus the reductions prescribed in paragraph (d) of this section. The amount received by the participant shall be the sum of any money plus the fair market value of property (other than money) received upon such withdrawal. The basis of the participating interest or portion thereof withdrawn shall be the money contributed by the participant to the common trust fund to acquire the participating interest or portion thereof withdrawn. Such basis shall not be reduced on account of the segregation of any investment in the common trust fund pursuant to the provisions of 12 CFR 206.17 (c) (7). For the purpose of making the adjustments, additions, and reductions with respect to basis as prescribed in this paragraph, the ward, rather than the guardian, shall be deemed to be the participant; and the grantor, rather than the trust to the extent that the income of the trust is taxable to the grantor pursuant to the provisions of section 166 or 167, shall be deemed to be the participant.

(c) *Additions to basis.* As prescribed in paragraph (b) of this section, in computing the gain or loss upon the withdrawal of a participating interest or portion thereof, there shall be added to the basis of the participating interest or portion thereof withdrawn an amount equal to the aggregate of the following items, to the extent that they were properly allocated to the participant for a taxable year of the common trust fund, and were not distributed to the participant prior to withdrawal:

(1) Wholly exempt income of the common trust fund for any taxable year,

(2) Net income of the common trust fund for the taxable years beginning after December 31, 1935, and prior to January 1, 1938,

(3) Net short-term capital gain of the common trust fund for each taxable year beginning after December 31, 1937,

(4) The excess of the gains over the losses recognized to the common trust fund for each taxable year beginning after December 31, 1937, upon sales or exchanges of capital assets held for more than 18 months (more than 6 months for taxable years beginning after December 31, 1941), and

(5) Ordinary net income of the common trust fund for each taxable year beginning after December 31, 1937.

(d) *Reductions in basis.* As prescribed in paragraph (b) of this section in computing the gain or loss upon the withdrawal of a participating interest or portion thereof, the basis of the participating interest or portion thereof withdrawn shall be reduced by such portions of the following items as were allocable to the participant with respect to the participating interest or portion thereof withdrawn:

(1) The amount of the excess of the allowable deductions of the common trust fund over its gross income for the taxable years beginning after December 31, 1935, and prior to January 1, 1938, and

(2) The amount of the net short-term capital loss, net long-term capital loss, and ordinary net loss of the common trust fund for each taxable year beginning after December 31, 1937.

§ 29.169–5 *Returns of common trust funds.* A bank maintaining a common trust fund shall make a return of income of the common trust fund, regardless of the amount of its net income. If a bank maintains more than one common trust fund, a separate return shall be made for each. The return shall be made for the taxable year of the common trust fund on the form prescribed by the Commissioner, in accordance with these regulations and the instructions on the form or issued therewith. The return of a common trust fund shall state specifically with respect to the fund the items of gross income and the deductions allowed under chapter 1, and shall include each participant's name and address, the ordinary net income or loss, and its proportionate share of gains and losses from sales or exchanges of capital assets. See § 29.169–2. A copy of the plan of the common trust fund must be filed with the return. If, however, a copy of such plan has once been filed with a return, it need not again be filed if the return contains a statement showing when and where it was filed. If the plan is amended in any way after such copy has been filed, a copy of the amendment must be filed with the return for the taxable year in which the amendment was made. Each such return shall be sworn to in the same manner as the return filed by the bank under section 52.

SEC. 170. NET OPERATING LOSSES [as added by sec. 211 (c), Rev. Act 1939].

The benefit of the deduction for net operating losses allowed by section 23 (s) shall be allowed to estates and trusts under regulations prescribed by the Commissioner with the approval of the Secretary. The benefit of such deduction shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.170–1 *Net operating loss deduction in the case of estates, trusts, and common trust funds*—(a) *Estates and trusts.* The net operating loss deduction allowed by section 23 (s), computed as provided by section 122, shall be available to estates and trusts generally, with the following exceptions and limitations:

(1) A net operating loss for a year for which a trust was exempt from tax under section 165 may not be used in the computation of the net operating loss carry-over.

(2) In computing gross income and deductions for the purposes of section 122, a trust shall exclude that portion of the income and deductions attributable to the grantor under section 166 and § 29.166–1 (c).

(3) An estate or trust shall not, for the purposes of section 122, avail itself of the deductions allowed by section 162.

(b) *Common trust funds.* The net operating loss deduction is not allowed to a common trust fund. Each participant in a common trust fund, however, will be allowed the benefits of such deduction.

In the computation of such deduction a participant in a common trust fund shall take into account its pro rata share of the income and losses of the common trust fund as prescribed by § 29.189–1 in the case of partners.

SEC. 171. INCOME OF AN ESTATE OR TRUST IN CASE OF DIVORCE, ETC. [As added by sec. 120 (c), Rev. Act 1942].

(a) *Inclusion in gross income.* There shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance the amount of the income of any trust which such wife is entitled to receive and which, except for the provisions of this section, would be includible in the gross income of her husband, and such amount shall not, despite section 166, section 167, or any other provision of this chapter, be includible in the gross income of such husband. This subsection shall not apply to that part of any such income of the trust which the terms of the decree or trust instrument fix, in terms of an amount of money or a portion of such income, as a sum which is payable for the support of minor children of such husband. In case such income is less than the amount specified in the decree or instrument, for the purpose of applying the preceding sentence, such income, to the extent of such sum payable for such support, shall be considered a payment for such support.

(b) *Wife considered a beneficiary.* For the purposes of computing the net income of the estate or trust and the net income of the wife described in section 22 (k) or subsection (a) of this section, such wife shall be considered as the beneficiary specified in this supplement. A periodic payment under section 22 (k) to any part of which the provisions of this supplement are applicable shall be included in the gross income of the beneficiary in the taxable year in which under this supplement such part is required to be included. [NOTE: Under section 120 (g) of the Revenue Act of 1942 section 171 is applicable "only with respect to taxable years beginning after December 31, 1941; except that if the first taxable year beginning after December 31, 1941, of the husband does not begin on the same day as the first taxable year beginning after December 31, 1941, of the wife, such amendments shall first become applicable in the case of the husband on the first day of the wife's first taxable year beginning after December 31, 1941, regardless of the taxable year of the husband in which such day falls."]

§ 29.171–1 *Income of trust in case of divorce, etc*—(a) *In general.* Section 171 (a) provides rules in certain cases for taxability of income of trusts as between spouses who are divorced or legally separated under a court order or decree. In such cases, the spouse actually entitled to receive payments from the trust is considered the beneficiary rather than the spouse in discharge of whose obligation such payments are made. For convenience, the beneficiary spouse will hereafter in this section and in § 29.171–2 be referred to as the "wife" and the obligor spouse from whom she is divorced or legally separated as the "husband." (See section 3797 (a) (17).) Thus, under section 171 (a) income of a trust:

(1) Which is paid, credited or to be distributed to the wife in a taxable year of the wife, and

(2) Which, except for the provisions of section 171, would be includible in the gross income of her husband,

shall be includible in her gross income and shall not be includible in his gross income.

Section 171 (a) does not apply in any case to which section 22 (k) applies. Although section 171 (a) and section 22 (k) seemingly cover some of the same situations, there are important differences between them. Thus, section 171 (a) applies, for example, to a trust created before the divorce or separation and not in contemplation of it, while section 22 (k) applies only if the creation of the trust or payments by a previously created trust are in discharge of a legal obligation imposed upon or assumed by the husband (or made specific) under the court decree or an instrument incident to the divorce or legal separation. On the other hand, section 22 (k) requires inclusion in the wife's income of the full amount of periodic payments received attributable to property in trust (whether or not out of trust income), while section 171 (a) requires amounts paid, credited or to be distributed to her to be included only to the extent such amounts are out of income of the trust for its taxable year (determined as provided in section 162).

Section 171 (a) is designed to produce uniformity as between cases described in section 171 (a) and cases not described in section 171 (a), where, in the former cases, without section 171 (a), the income of a so-called alimony trust would be taxable to the husband because of his continuing obligation to support his former wife, and where, in the latter cases, the income of a so-called alimony trust is taxable to the former wife because of the termination of the husband's obligation. Furthermore, section 171 (a) taxes trust income to the wife in all cases where under prior law the husband would be taxed not only because of the discharge of his alimony obligation but also because of his retention of control over the income or trust corpus. Section 171 (a) applies whether or not the wife is the beneficiary under the terms of the trust instrument or is an assignee of a beneficiary.

The application of section 171 (a) may be illustrated by the following examples, in which it is assumed that both the husband and wife make their income tax returns on a calendar year basis:

Example (1). Upon the marriage of H and W, H irrevocably transfers property in trust to pay the income therefrom to W for her life for support, maintenance, and all other expenses. Some years later, W obtains a legal separation from H under an order of court. W, relying upon the income from the trust payable to her, does not ask for any provision for her support and none is ordered by the court; the court, however, has jurisdiction under the law of the State to order at any time prior to an absolute divorce that provision be made by H for W's support. Under the provisions of section 171 (a), the income of the trust which becomes payable to W after the order of separation is includible in her income and is deductible by the trust. No part thereof is includible in H's income or deductible by him.

Example (2). H transfers property in trust for the benefit of W, retaining the power to revoke the trust at any time. H, however, promises that if he revokes the trust he will transfer to W property in the value of $100,000. The transfer in trust and the agreement were not incident to divorce, but some years later W divorces H. The court decree is silent as to alimony and the trust. After the divorce, income of the trust which becomes payable to W is taxable to her, and is not taxable to H or deductible by him. If H later terminates the trust and transfers $100,000 of property to W, such $100,000 is not income to W nor deductible by H.

(b) *Alimony trust income designated for support of minor children.* Section 171 (a) does not require the inclusion in the wife's income of trust income which the terms of the decree or trust instrument fix in terms of an amount of money or a portion of such income as a sum which is payable for the support of minor children of the husband. The statute prescribes the treatment in cases where under the terms of the decree or trust instrument a specific amount of trust income is to be paid but a lesser amount becomes payable. In such cases, to the extent of the sum which would be payable for such support out of the originally specified amount of trust income, such trust income is considered payable for support of such minor children. This rule is similar to that provided in the case of periodic payments under section 22 (k). See § 29.22 (k)–1 (d).

§ 29.171–2 *Application of trust rules to alimony payments.* For the purpose of the application of sections 162, 163, and 164, the wife described in section 171 or section 22 (k) who is entitled to receive payments attributable to property in trust is considered a beneficiary of the trust, whether or not the payments are made for the benefit of the husband in discharge of his obligations.

A periodic payment includible in the wife's gross income under section 22 (k) attributable to property in trust shall be included in full in her gross income in her taxable year in which any part is required to be included under sections 162 and 164. Assume, for example, in a case in which both the wife and the trust file income tax returns on the calendar year basis, that an annuity of $5,000 is to be paid to the wife by the trustee every December 31 (out of trust income if possible and, if not, out of corpus) pursuant to the terms of a divorce decree. Of the $5,000 distributable on December 31, 1942, $4,000 is payable out of income and $1,000 out of corpus. The actual distribution is made in 1943. Although the periodic payment is received by the wife in 1943, since under sections 162 and 164 the $4,000 income distributable on December 31, 1942, is to be included in the wife's income for 1942, the $1,000 payment out of corpus is to be included in her income for 1942.

SEC. 172. ALLOWANCE OF AMORTIZATION DEDUCTION [as added by sec. 155 (g), Rev. Act 1942].

The benefit of the deduction for amortization of emergency facilities allowed by section 23 (t) shall be allowed to estates and trusts in the same manner and to the same extent as in the case of an individual. The allowable deduction shall be apportioned between the income beneficiaries and the fidu-

ciary under regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.172–1 *Amortization of emergency facility of estate or trust.* In the case of an emergency facility, as defined in section 124 (e), acquired or completed by an estate or trust after December 31, 1939, such estate or trust is entitled to take amortization deductions with respect thereto in the same manner and to the same extent as in the case of an individual. See section 23 (t) and section 124 and the regulations thereunder. The principles governing the apportionment of depreciation in the case of property held in trust are applicable with respect to the amortization of an emergency facility of an estate or trust. See § 29.23 (l)–1.

PARTNERSHIPS

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

§ 29.181–1 *Partnerships.* Partnerships as such are not subject to the income tax imposed by chapter 1, but are required to make returns of income. (See sections 187 and 188.) For definition of what the term "partnership" includes, see section 3797 (a) (2).

SEC. 182. TAX OF PARTNERS [as amended by sec. 150 (g), Rev. Act 1942].

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

§ 29.182–1 *Distributive share of partners.* (a) Each partner is required to include in his return for his taxable year within which or with which the taxable year of the partnership ends, whether or not distributed:

(1) As part of his gains and losses from sales or exchanges of capital assets held for not more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months.

(2) As part of his gains and losses from sales or exchanges of capital assets held for more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than six months.

(3) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(b) If separate returns are made by the husband and wife domiciled in a community property State, and the husband only is a member of a partnership, the part of his distributive share of gains and losses of the partnership from sales or exchanges of capital assets or the part of his distributive share of ordinary net income or ordinary net loss, which is, or is derived from, community property should be reported by the husband and by the wife in equal proportions. In the case of a partnership closely related to other trades or businesses, see section 45.

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME [as amended by sec. 150 (g), Rev. Act 1942].

(a) *General rule.* The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual except as provided in subsections (b) and (c).

(b) *Segregation of items*—(1) *Capital gains and losses.* There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) *Ordinary net income or loss.* After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) *Charitable contributions.* In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

§ 29.183–1 *Computation of partnership income.* The net income of the partnership shall be computed in the same manner and on the same basis as the net income of an individual, except that:

(a) The partnership is required to segregate its gains and losses from sales or exchanges of capital assets. A partnership is not allowed the benefit of section 117 (e).

(b) The partnership is further required, after excluding all items described in paragraph (a), to compute (1) an ordinary net income which consists of the excess of gross income over the deductions, or (2) an ordinary net loss which consists of the excess of the deductions over the gross income. In the computation of its ordinary net income or ordinary net loss, the partnership is denied the so-called charitable contribution deduction allowed by section 23 (o), but each partner is considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of a character which would be allowed to the partnership as a deduction if section 183 (c) had not been enacted. Payments made to a partner for services rendered and for interest on capital contributions are not deductible in computing the net income of the partnership, such payments being held to represent a division of partnership profits.

SEC. 184. CREDITS AGAINST NET INCOME [as amended by sec. 162 (f), Rev. Act 1942].

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership. If the partnership elects under section 125 to treat the premium on bonds, the interest on which is allowable as a credit under section 25 (a) (1) or (2), as amortizable, for the purposes of the preceding sentence the partner's proportionate share of the interest received by the partnership shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 23 (v) as is attributable to such share.

§ 29.184–1. *Credits allowed partners.* The credits against net income provided in section 25 are not applicable to partnerships as such. An individual partner, however, is entitled for the purpose of the normal tax to a credit against his net income, in addition to the credits allowed to him under section 25, of his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership. There shall be included in the return of the partnership a statement of the amounts of such interest and the proportionate share thereof of each partner. (For reduction of credit for such interest on account of amortizable bond premium, see § 29.125–9.)

SEC. 185. EARNED INCOME.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership.

§29.185–1 *Earned income credit of partners.* For the purpose of computing the earned income credit against net income (see section 25 (a) (3) and (4)), a member of a partnership is entitled to treat a proper part of his distributive share of the partnership net income as earned income. Such part cannot exceed a reasonable allowance as compensation for personal services actually rendered by the partner in connection with the partnership business. In the case of a partnership which is engaged in a trade or business in which capital is a material income-producing factor and in the trade or business of which the partner renders personal services which are material to the earning of the partnership income, the earned income of the partner from the partnership is a reasonable allowance as compensation for the personal services actually rendered by him, but not in excess of 20 percent of his share of the net profits of the partnership (computed without deduction for so-called salaries to members). In such a case, if reasonable compensation is less than 20 percent of the partner's share of the net profits, the earned income is the full amount of the reasonable compensation,

but, if reasonable compensation is more than 20 percent of the partner's share of the net profits, then the earned income is 20 percent of the partner's share of such profits.

There must be included in the return of the partnership a statement showing the names of the members and the amount (determined in accordance with the first paragraph of this section) of each partner's distributive share of the partnership net income which consists of earned income.

Example. A partnership composed of A, B, and C is engaged in the retail men's clothing business. Each partner is entitled to one-third of the net profits, after deduction of so-called salaries to members. A devotes most of his time to the business and is paid a salary of $10,000. B devotes half of his time to the business and is paid a salary of $5,000. C devotes none of his time to the business and receives no salary. The net profits of the partnership for the taxable year, computed without deduction for so-called salaries to members, are $24,000. The earned income of the partners from the partnership is as follows: Although A received a salary of $10,000 and B a salary of $5,000, since the partnership is engaged in a business in which capital is a material income-producing factor, the earned income of each from the partnership is limited to 20 percent of his share of the net profits. A's share of the net profits is $13,000 ($10,000 (salary) + $3,000 (⅓ of net profits after deduction of $15,000 for salaries)). Twenty percent of $13,000 is $2,600, to which amount A's earned income from the partnership is limited. Since B's share of the net profits is $8,000 ($5,000 + $3,000), 20 percent thereof, or $1,600, is B's earned income from the partnership. C has no earned income from the partnership, since he renders no personal services in connection with the partnership business.

SEC. 186. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

§ 29.187–1 *Partnership returns.* Every partnership shall make a return of income, regardless of the amount of its net income (see section 3797 (a) (2), defining the term "partnership"). The return shall be on Form 1065; shall state specifically the information required to be stated by the return form; shall be filled in according to the instructions contained thereon, or issued with respect thereto; and shall be sworn to by one of the partners. Such return shall be made for the taxable year of the partnership, that is, for its annual accounting period (fiscal year or calendar year, as the case may be), irrespective of the taxable years of the partners. (See sections 182 and 183.) If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of section 47, except that the return shall not be placed on an annual basis under section 47 (c).

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

SEC. 189. NET OPERATING LOSSES [as added by sec. 211 (d), Rev. Act 1939.]

The benefit of the deduction for net operating losses allowed by section 23 (s) shall not be allowed to a partnership but shall be allowed to the members of the partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.189–1 *Net operating loss deduction in the case of partners.* The benefit of the deduction for net operating losses provided by section 23 (s) shall not be allowed to a partnership. In computing his own net operating loss or his own net income (where required to be computed in accordance with the exceptions and limitations provided in section 122 (d) (1) to (4), inclusive) for any taxable year for the purposes of the computations required by section 122, however, each partner shall take into account the income and losses of the partnership in accordance with sections 182 to 188, inclusive, with the following exceptions and limitations:

(a) *Exceptions and limitations applicable in computation of partner's net operating loss*—(1) *Long-term capital gains and losses.* The partnership's gains and losses from sales or exchanges of capital assets held for more than six months shall be taken into account without regard to the percentage provisions of section 117 (b). The business gains and losses from sales or exchanges of capital assets held for more than six months and the nonbusiness gains and losses from such sales or exchanges shall be segregated and his distributive share of the partnership's business gains or losses from such sales or exchanges and the partnership's nonbusiness gains and losses from such sales or exchanges shall be included by each partner as business and nonbusiness gains or losses from the sales or exchanges of capital assets held for more than six months, respectively.

(2) *Short-term capital gains and losses.* The partnership's business gains and losses from sales or exchanges of capital assets held for not more than six months and the partnership's nonbusiness gains and losses from such sales or exchanges shall be segregated, and his distributive share of such business gains or losses and such non-business gains or losses shall be included by each partner as business and nonbusiness gains or losses from sales or exchanges of capital assets held for not more than six months, respectively.

(3) *Ordinary net income or loss.* After excluding all items required to be segregated by (1) and (2) above, there shall be computed:

(i) A business ordinary net income of the partnership, which shall consist of the excess of the business gross income over the business deductions; or

(ii) A business ordinary net loss of the partnership, which shall consist of the excess of the business deductions over the business gross income; and

(iii) A nonbusiness ordinary net income of the partnership, which shall consist of the excess of the nonbusiness gross income over the nonbusiness deductions; or

(iv) A nonbusiness ordinary net loss of the partnership, which shall consist of the excess of the nonbusiness deductions over the nonbusiness gross income.

In making the above computations the limitations and exceptions provided by section 122 (d) (1) and (2) shall be applied.

His distributive share of a business ordinary net income of the partnership shall be included by each partner as ordinary business gross income, and of a business ordinary net loss of the partnership as an ordinary business deduction. His distributive share of a nonbusiness ordinary net income of the partnership shall be included by each partner as ordinary nonbusiness gross income, and of a nonbusiness ordinary net loss of the partnership as an ordinary nonbusiness deduction.

(b) *Exceptions and limitations applicable in computation of partner's net income.* (1) The ordinary net income or ordinary net loss of the partnership shall be computed with the exceptions and limitations provided in section 122 (d) (1) and (2).

(2) The gains and losses from sales or exchanges of capital assets of the partnership shall be taken into account without regard to the percentage provisions of section 117 (b).

SEC. 190. ALLOWANCE OF AMORTIZATION DEDUCTION [as added by sec. 155 (h), Rev. Act 1942].

In the case of emergency facilities of a partnership, the benefit of the deduction for amortization allowed by section 23 (t) shall not be allowed to the members of a partnership but shall be allowed to the partnership in the same manner and to the same extent as in the case of an individual.

§ 29.190–1 *Amortization of emergency facility of partnership.* In the case of an emergency facility, as defined in section 124 (e), acquired or completed by a partnership after December 31, 1939, the partnership is entitled to take amortization deductions with respect thereto in the same manner and to the same extent as in the case of an individual. See section 23 (t) and section 124 and the regulations thereunder. Amortization deductions with respect to an emergency facility of a partnership are not allowed to the members of the partnership.

INSURANCE COMPANIES

SEC. 202. LIFE INSURANCE COMPANIES [as amended by sec. 203, Rev. Act 1939; sec. 163 (a), Rev. Act 1942].

(a) *Imposition of tax*—(1) *In general.* There shall be levied, collected, and paid for each taxable year upon the adjusted normal-tax net income (as defined in section 202)

and upon the adjusted corporation surtax net income (as defined in section 203) of every life insurance company taxes at the rates provided in section 13 or section 14 (b) and in section 15 (b).

(2) *Foreign life insurance companies.* A foreign life insurance company carrying on a life insurance business within the United States if with respect to its United States business it would qualify as a life insurance company under subsection (b) shall be taxable in the same manner as a domestic life insurance company except that the determinations necessary for the purposes of this chapter shall be made on the basis of the income, disbursements, assets, and liabilities reported in the annual statement for the taxable year of the United States business of such company on the form approved for life insurance companies by the National Association of Insurance Commissioners.

(3) *No United States insurance business.* Foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as other foreign corporations.

(b) *Definition of life insurance company.* When used in this chapter, the term "life insurance company" means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, and the life insurance reserves (as defined in subsection (c) (2)) plus unearned premiums and unpaid losses on noncancellable life, health, or accident policies not included in life insurance reserves, of which comprise more than 50 per centum of its total reserves. For the purpose of this subsection, total reserves means life insurance reserves, unearned premiums and unpaid losses not included in life insurance reserves, and all other insurance reserves required by law. For taxable years beginning after December 31, 1943, a burial or funeral benefit insurance company engaged directly in the manufacture of funeral supplies or the performance of funeral services shall not be taxable under this section but shall be taxable under section 204 or section 207.

(c) *Other definitions.* In the case of a life insurance company—

(1) *Gross income.* The term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(2) *Life insurance reserves.* The term "life insurance reserves" means amounts which are computed or estimated on the basis of reccgnized mortality or morbidity tables and assumed rates of interest, and which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies. Such life insurance reserves, except in the case of policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation and except as hereinafter provided in the case of assessment life insurance, must also be required by law. In the case of an assessment life insurance company or association the term "life insurance reserves" includes sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation or association, or bylaws approved by State Insurance Commissioner of such company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

(3) *Adjusted reserves.* The term "adjusted reserves" means life insurance reserves plus 7 per centum of that portion of such reserves as are computed on a preliminary term basis.

(4) *Reserve earnings rate.* The term "reserve earnings rate" means a rate computed by adding 2.1125 per centum (65 per centum of 3¼ per centum) to 35 per centum of the average rate of interest assumed in computing life insurance reserves. Such average rate shall be calculated by multiplying each assumed rate of interest by the means of the amounts of the adjusted reserves computed at that rate at the beginning and end of the taxable year and dividing the sum of the products by the mean of the total adjusted reserves at the beginning and end of the taxable year.

(5) *Reserve for deferred dividends.* The term "reserve for deferred dividends" means sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract.

(6) *Interest paid.* The term "interest paid" means—

(A) All interest paid within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for, by the taxpayer) the interest upon which is wholly exempt from taxation under this chapter, and

(B) All amounts in the nature of interest, whether or not guaranteed, paid within the taxable year on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve, at the time of payment, life, health, or accident contingencies.

(7) *Net income.* The term "net income" means the gross income less—

(A) *Tax-free interest.* The amount of interest received during the taxable year which under section 22 (b) (4) is excluded from gross income;

(B) *Investment expenses.* Investment expenses paid during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this subparagraph shall not exceed one-fourth of 1 per centum of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which net income computed without any deduction for investment expenses allowed by this subparagraph, or for tax-free interest allowed by subparagraph (A), exceeds 3¾ per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(C) *Real estate expenses.* Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes;

(D) *Depreciation.* A reasonable allowance, as provided in section 23 (l), for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence.

(d) *Rental value of real estate.* The deduction under subsection (c) (7) (C) or (c) (7) (D) of this section on account of any real estate owned and occupied in whole or in part by a life insurance company, shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

(e) *Amortization of premium and accrual of discount.* The gross income, the deduction provided in section 201 (c) (7) (A) and the credit allowed against net income in section 26 (a) shall each be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined (1) in accordance with the method regularly employed by such company, if such method is reasonable, and (2) in all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

(f) *Double deductions.* Nothing in this section or in section 202 or 203 shall be construed to permit the same items to be twice deducted.

(g) *Credits under section 26.* For the purposes of this section, in computing normal tax net income and corporation surtax net income, the credits provided in section 26 shall be allowed in the manner and to the extent provided in sections 13 (a) and 15 (a).

§ 29.201–1 *Tax on life insurance companies.* All life insurance companies (including a foreign life insurance company carrying on a life insurance business within the United States if with respect to its United States business it would qualify as a life insurance company under section 201 (b)) are subject to both normal tax and surtax. The normal tax is imposed on the adjusted normal-tax net income (as defined in section 202) and the surtax is imposed on the adjusted corporation surtax net income (as defined in section 203) at the rates provided in section 13 or section 14 (b) and in section 15 (b).

The net income of life insurance companies differs from the net income of other corporations. See section 201 (c). Life insurance companies are entitled, in computing normal-tax net income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a), respectively. The gross income, the deduction under section 201 (c) (7) (A) for wholly tax-exempt interest, and the credit under section 26 (a) for partially tax-exempt interest, are decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. See section 201 (e) and § 29.201–9. Such companies are not subject to the provisions of section 117 (capital gains and losses) nor to the provisions of section 125 (amortizable bond premiums). For computation of the adjusted normal-tax net income from

normal-tax net income and the adjusted corporation surtax net income from corporation surtax net income, see §§ 29.202–1, 29.202–2 and 29.203–1.

All provisions of the Internal Revenue Code and of these regulations not inconsistent with the specific provisions of sections 201 to 203, inclusive, are applicable to the assessment and collection of the tax imposed by section 201 (a), and life insurance companies are subject to the same penalites as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120L.

Foreign life insurance companies not carrying on an insurance business within the United States are not taxable under section 201 (a), but are taxable as other foreign corporations. See section 231.

§ 29.201–2 *Foreign life insurance companies.* A foreign life insurance company carrying on a life insurance business within the United States, if with respect to its United States business it would qualify as a life insurance company under section 201 (b), is taxable on its income received during the taxable year from interest dividends, and rents, from sources within and without the United States, pertaining to its United States business. Such a company is taxable in the same manner as a domestic life insurance company except that the determinations necessary for the purposes of chapter 1, such as gross income, the adjustment for certain reserves, deductions and limitations on deductions, amortization of premiums and accrual of discount and the credits provided in section 26, shall be made on the basis of the income disbursements, assets, and liabilities reported in the annual statement for the taxable year of the United States business of such company on the form approved for life insurance companies by the National Association of Life Insurance Commissioners. This statement is presumed clearly to reflect the income disbursements, assets, and liabilities of the United States business of the company and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose.

§ 29.201–3 *Life insurance companies; definition.* The term "life insurance company" as used in chapter 1 is defined in section 201 (b). In determining whether an insurance company is a life insurance company the life insurance reserves (as defined in section 201 (c) (2)) plus any unearned premiums and unpaid losses on noncancelable life, health, or accident policies, not included in "life insurance reserves" must comprise more than 50 percent of its total reserves (as defined in section 201 (b)). An insurance company writing only noncancelable life, health, or accident policies and having no "life insurance reserves" may qualify as a life insurance company if its unearned premiums and unpaid losses on such policies comprise more than 50 percent of its total reserves. A noncancelable insurance policy means a contract which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premium must be carried to cover that obligation. A burial or funeral benefit insurance company qualifying as a life insurance company shall continue to be taxed under section 201 for taxable years beginning prior to January 1, 1944. For taxable years beginning after December 31, 1943, any such company engaged directly in the manufacture of funeral supplies or the performance of funeral services will be taxable under section 204 or section 207 as an insurance company other than life. For the definition of an insurance company see § 29.3797–7.

§ 29.201–4 *Life insurance reserves.* The term "life insurance reserves" is defined in section 201 (c) (2). Generally, such reserves, as in the case of level premium life insurance, are held to supplement the future premium receipts when the latter, alone, are insufficient to cover the increased risk in the later years. In the case of cancelable health and accident policies and similar cancelable contracts, the unearned premiums held to cover the risk for the unexpired period covered by the premiums are not included in life insurance reserves. Unpaid loss reserves for noncancelable health and accident policies are included in life insurance reserves if they are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest.

In the case of an assessment life insurance company or association, life insurance reserves include sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation or association of such company or association, or by-laws (approved by the State insurance commissioner) of such company or association, exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

Life insurance reserves, except as otherwise provided in section 201 (c) (2), must be required by law either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, life insurance reserves do not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, and unpaid brokerage; nor do they include the net value of risks reinsured in other solvent companies; liability for premiums paid in advance; liability for annual and deferred dividends declared or apportioned; liability for dividends left on deposit at interest; liability for accrued but unsettled policy claims whether known or unreported; liability for supplementary contracts not involving, at the time with respect to which the liability is computed, life, health or accident contingencies.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Only reserves which are required by law or insurance department ruling, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will, except as otherwise specifically provided in section 201(c)(2), be considered as life insurance reserves. A company is permitted to make use of the highest aggregate reserve required by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized mortality or morbidity tables covering disability benefits of the kind contained in policies issued by this particular class of companies but they need not be required by law.

§ 29.201–5 *Interest paid.* Interest paid is one of the elements to be used, together with adjusted reserves, reserve earnings rate, and reserve for deferred dividends, in arriving at the figure to be determined and proclaimed by the Secretary under the formula set forth in section 202 (b) (see § 29.202–1). Interest paid consists of (1) interest paid on indebtedness (except indebtedness incurred or continued to purchase or carry tax-exempt securities as set forth in section 201(c)(6)(A)) and (2) amounts in the nature of interest paid on certain contracts, as provided in section 201 (c) (6)(B). Interest on indebtedness includes interest on dividends held on deposit and surrendered during the taxable year but does not include interest paid on deferred dividends the reserve for which is used in determining the policy and other liability credit provided in section 202 (b). Life insurance reserves as defined in § 29.201–4 are not indebtedness. Dividends left with the company to accumulate at interest are a debt and not a reserve liability. Amounts in the nature of interest include so-called excess-interest dividends as well as guaranteed interest paid within the taxable year on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve at the time of payment, life, health, or accident contingenices. It is immaterial whether the optional mode of settlement specified in the insurance or annuity contract arises from an option exercised by the insured during his or her lifetime or from an option exercised by a beneficiary after the policy has matured, frequently referred to as a supplementary contract not involving life contingencies; for example, a contract to pay the insurance benefit in 10 annual installments. No distinction is made based on the person choosing the method

of payment and the full amount of the interest paid and not merely the guaranteed interest is considered as interest paid.

§ 29.201–6 *Adjusted reserves.* For the purpose of determining the figure to be proclaimed by the Secretary under the formula set forth in section 202 (b), certain reserves computed on a preliminary term method are to be adjusted by increasing such reserves by 7 percent (see § 29.202–1). The reserves to be thus adjusted are reserves computed on preliminary term methods, such as the Illinois Standard, or the Select and Ultimate methods. Only reserves on policies in the modification period are to be so adjusted. Where reserves under a preliminary term method are the same as on the level premium method, and in the case of reserves for extended or paid-up insurance, no adjustment is to be made. The reserves as thus adjusted, and the rate of interest on which they are computed should be reported in Schedule A, Form 1120L.

§ 29.201–7 *Net income and deductions*—(a) *In general.* The net income of a life insurance company is its gross amount of income received during the taxable year from interest, dividends, and rents, less the deductions provided in section 201 (c) (7) for wholly tax-exempt interest, investment expenses, real estate expenses, and depreciation. In addition to the limitations on deductions relating to real estate owned and occupied by a life insurance company provided in section 201 (d), the limitations on the adjustment for amortization of premium and accrual of discount provided in section 201 (e), and the limitation on the deduction for investment expenses where general expenses are allocated to investment income provided in section 201 (c) (7) (B), life insurance companies are subject to the limitation on deductions relating to wholly tax-exempt income provided in section 24 (a) (5). Life insurance companies are not entitled to the net operating loss deduction provided in section 23 (s).

(b) *Wholly tax-exempt interest.* Interest which in the case of other taxpayers is excluded from gross income by section 22 (b) (4) but included in the gross income of a life insurance company by section 201 (c) (1) is allowed as a deduction from gross income by section 201 (c) (7) (A).

(c) *Investment expenses.* The term "general expenses" as used in the Internal Revenue Code means any expense incurred for the benefit of more than one department of the company rather than for the benefit of a particular department thereof. Any assignment of such expense to the investment department of the company for which a deduction is claimed under section 201 (c) (7) (B) subjects the entire deduction for investment expenses to the limitation provided in that section. The accounting procedure employed is not conclusive as to whether any assignment has in fact been made. Investment expenses do not include Federal income and excess profits taxes.

If no general expenses are assigned to or included in investment expenses the deduction may consist of investment expenses actually paid during the taxable year in which case an itemized schedule of such expenses must be appended to the return.

Invested assets for the purpose of section 201 (c) (7) (B) and this section are those which are owned and used, and to the extent used, for the purpose of producing the income specified in section 201 (c) (1). They do not include real estate owned and occupied, and to the extent owned and occupied, by the company. If general expenses are assigned to or included in investment expenses the maximum allowance will not be granted unless it is shown to the satisfaction of the Commissioner that such allowance is justified by a reasonable assignment of actual expenses.

Wages or salaries included in investment expenses shall be disallowed as a deduction if determined by the National War Labor Board, the Secretary of Agriculture, or the Commissioner to have been made in contravention of the Act of October 2, 1942 (56 Stat. 765, 5 U. S. C., Sup. 961), entitled "An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes," or of the regulations, orders, or rulings promulgated thereunder.

(d) *Taxes and expenses with respect to real estate.* The deduction for taxes and expenses under section 201 (c) (7) (C) includes taxes and expenses paid during the taxable year exclusively upon or with respect to real estate owned by the company and any sum representing taxes imposed upon a shareholder of the company upon his interest as shareholder which is paid by the company without reimbursement from the shareholder. No deduction shall be allowed, however, for taxes, expenses, and depreciation upon or with respect to any real estate owned by the company except to the extent used for the purpose of producing investment income. (See paragraph (c) of this section.) As to real estate owned and occupied by the company see § 29.201–8.

(e) *Depreciation.* The deduction allowed for depreciation is, except as provided in section 201 (d), identical with that allowed other corporations by section 23 (l). The amount allowed by section 23 (l) in the case of life insurance companies is limited to depreciation sustained on the property used, and to the extent used, for the purpose of producing the income specified in section 201 (c) (1).

§ 29.201–8 *Real estate owned and occupied.* The amount allowable as a deduction for taxes, expenses, and depreciation upon or with respect to any real estate owned and occupied in whole or in part by a life insurance company is limited to an amount which bears the same ratio to such deduction (computed without regard to this limitation) as the rental value of the space not so occupied bears to the rental value of the entire property. For example, if the rental value of the space not occupied by the company is equal to one-half of the rental value of the entire property, the deduction for taxes, expenses, and depreciation is one-half of the taxes, expenses, and depreciation on account of the entire property. Where a deduction is claimed as provided in this section, the parts of the property occupied and the parts not occupied by the company, together with the respective rental values thereof, must be shown in a statement accompanying the return.

§ 29.201–9 *Amortization of premium and accrual of discount.* Section 201 (e) provides for certain adjustments on account of amortization of premium and accrual of discount on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such adjustments are limited to the amount of appropriate amortization or accrual attributable to the taxable year with respect to such securities which are not in default as to principal or interest and which are amply secured. The question of ample security will be resolved according to the rules laid down from time to time by the National Association of Insurance Commissioners. The adjustment for amortization of premium decreases, and for accrual of discount increases, (a) the gross income, (b) the deduction for wholly tax-exempt interest, and (c) the credit for partially tax-exempt interest.

The premium for any such security is the excess of its acquisition value over its maturity value and the discount is the excess of its maturity value over its acquisition value. The acquisition value of any such security is its cost (including buying commissions or brokerage but excluding any amounts paid for accrued interest) if purchased for cash, or if not purchased for cash, then its fair market value. The maturity value of any such security is the amount payable thereunder either at the maturity date or an earlier call date. The earlier call date of any such security may be the earliest call date specified therein as a day certain, the earliest interest payment date if it is callable or payable at such date, the earliest date at which it is callable at par, or such other call or payment date, prior to maturity, specified in the security as may be selected by the life insurance company. A life insurance company which adjusts amortization of premium or accrual of discount with reference to a particular call or payment date must make the adjustments with reference to the value on such date and may not, after selecting such date, use a different call or payment date, or value, in the calculation of such amortization or discount with respect to such security unless the security was not in fact called or paid on such selected date.

The adjustments for amortization of premium and accrual of discount will be determined:

(1) According to the method regularly employed by the company, if such method is reasonable, or

(2) According to the method prescribed by this section.

A method of amortization of premium or accrual of discount will be deemed "regularly employed" by a life insurance company if the method was consistently followed in taxable years beginning prior to January 1, 1942, or if for taxable years beginning on or after such date the company (including a company which followed a different method in taxable years beginning prior to January 1, 1942) initiates on or before March 15, 1943, or in the first taxable year for which the adjustments are made, a reasonable method of amortization of premium or accrual of discount and consistently follows such method thereafter. Ordinarily, a company regularly employs a method in accordance with the statute of some State, Territory, or the District of Columbia, in which it operates.

The method of amortization and accrual prescribed by this section is as follows:

(i) The premium (or discount) shall be determined in accordance with this section; and

(ii) The appropriate amortization of premium (or accrual of discount) attributable to the taxable year shall be an amount which bears the same ratio to the premium (or discount) as the number of months in the taxable year during which the security was owned by the life insurance company bears to the number of months between the date of acquisition of the security and its maturity or earlier call date, determined in accordance with this section. For the purpose of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

SEC. 202. ADJUSTED NORMAL-TAX NET INCOME [as amended by sec. 163 (a), Rev. Act 1942].

(a) *Definition.* For the purposes of section 201, the term "adjusted normal-tax net income" means the normal-tax net income minus the reserve and other policy liability credit provided in subsection (b) and plus the amount of the adjustment for certain reserves provided in subsection (c).

(b) *Reserve and other policy liability credit.* As used in this section the term "reserve and other policy liability credit" means an amount computed by multiplying the normal-tax net income by a figure, to be determined and proclaimed by the Secretary for each taxable year. This figure shall be based on such data with respect to life insurance companies for the preceding taxable year as the Secretary considers representative and shall be computed in accordance with the following formula: The ratio which (1) the aggregate of the sums of (A) 2 per centum of the reserves for deferred dividends, (B) interest paid, and (C) the product of (i) the mean of the adjusted reserves at the beginning and end of the taxable year and (ii) the reserve earnings rate bears to (2) the aggregate of the excess of net incomes computed without any deduction for tax-free interest, over the adjustment for certain reserves provided in subsection (c).

(c) *Adjustment for certain reserves.* In the case of a life insurance company writing contracts other than life insurance or annuity contracts (either separately or combined with noncancellable health and accident insurance), the term "adjustment for certain reserves" means an amount equal to 3¼ per centum of the unearned premiums and unpaid losses on such other contracts which are not included in life insurance reserves. For the purposes of this subsection such unearned premiums shall not be considered to be less than 25 per centum of the net premiums written during the taxable year on such other contracts.

§ 29.202–1 *Reserve and other policy liability credit for adjusted normal tax net income.* Life insurance companies in computing adjusted normal-tax net income are allowed a "reserve and other policy liability credit" in lieu of a deduction for the interest allowed on their reserves, for interest paid and for deferred dividends. This credit is a flat percentage of normal-tax net income. The figure is the same for all companies and is determined on the basis of the aggregate of the interest allowed on reserves, interest paid, and 2 percent of the reserves held for deferred dividends, as provided in section 202 (b), for all companies. The figure for each taxable year is to be determined and proclaimed by the Secretary, based on such data with respect to life insurance companies for the preceding taxable year as the Secretary considers representative for such year.

The application of the reserve and other policy liability credit for the purpose of this section and section 203 may be illustrated by the following examples:

Example (1). The X Life Insurance Company for the calendar year 1942 has gross income, consisting of interest and rents, of $4,000,000, of which $700,000 consists of wholly tax-exempt interest. It has investment expenses of $100,000, real estate expenses of $80,000, and depreciation of $20,000. Its net income and its normal-tax net income is accordingly $3,100,000 ($4,000,000 less investment expenses, real estate expenses, and depreciation amounting to $200,000 and wholly tax-exempt interest of $700,000). Since the Secretary has determined and proclaimed that for the taxable year 1942 the figure based on data for the taxable year 1941 is 0.93, the X Life Insurance Company is entitled to a credit of ¢2,883,000 ($3,100,000 × 0.93) and its adjusted normal-tax net income as well as its adjusted corporation surtax net income is $217,000 ($3,100,000 − $2,883,000).

Example (2). If in example (1) $100,000 of the $4,000,000 gross income of the X Life Insurance Company for the calendar year 1942 consisted of partially tax-exempt interest, in addition to the $700,000 of wholly tax-exempt interest, its corporation surtax net income and adjusted corporation surtax net income would be the same as in the above example. Its normal-tax net income, however, would be $3,000,000 ($4,000,000 less $200,000 less $700,000 less $100,000), its credit it would be $2,790,000 ($3,000,000 × 0.93) and its adjusted normal-tax net income would be $210,000 ($3,000,000 − $2,790,000).

§ 29.202–2 *Adjustment for certain reserves.* A life insurance company writing contracts other than life insurance or annuity contracts (either separately or combined with noncancellable health and accident insurance contracts) must add to its normal-tax net income and to its corporation surtax net income, as an offset to its reserve and other policy liability credit, an amount equal to 3¼ percent of the mean of the unearned premiums and unpaid losses at the beginning and end of the taxable year on such other contracts as are not included in life insurance reserves. If such unearned premiums, however, are less than 25 percent of the net premiums written during the taxable year on such other contracts, then the amount to be added to normal-tax net income and to corporation surtax net income is 3¼ percent of 25 percent of the net premiums written during the taxable year on such other contracts plus 3¼ percent of the mean of the unpaid losses at the beginning and end of the taxable year on such other contracts. The term "unearned premiums" when used in this section has the same meaning as in section 204 (b) (5) and the regulations thereunder.

SEC. 203. ADJUSTED CORPORATION SURTAX NET INCOME [as amended by sec. 211 (e), Rev. Act 1939; sec. 163 (a), Rev. Act 1942].

(a) *Definition.* For the purposes of section 201, the term "adjusted corporation surtax net income" means the corporation surtax net income minus the reserve and other policy liability credit and plus the adjustment for certain reserves provided in section 202 (c).

(b) *Reserve and other policy liability credit.* As used in this section, the term "reserve and other policy liability credit" means an amount computed by multiplying the corporation surtax net income by the figure determined and proclaimed under section 202 (b).

§ 29.203–1 *Reserve and other policy liability credit for adjusted corporation surtax net income.* Life insurance companies in computing adjusted corporation surtax net income are allowed a reserve and other policy liability credit. This credit is similar to that provided in section 202 except that it is based on corporation surtax net income, which includes partially tax-exempt interest. See § 29.202–1 for the application and effect of this provision.

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL [AND MUTUAL MARINE INSURANCE COMPANIES] [as amended by secs. 204, 226 (a), Rev. Act 1939; secs. 124 (b), 160 (d), 164, Rev. Act 1942].

(a) *Imposition of tax*—(1) *In general.* There shall be levied, collected, and paid for each taxable year upon the normal-tax net income and upon the corporation surtax net income of every insurance company (other than a life or mutual insurance company) and every mutual marine insurance company taxes at the rates specified in section 13 or section 14 (b) and in section 15 (b).

(2) *Normal-tax and corporation surtax net income of foreign insurance companies other than life or mutual and foreign mutual marine.* In the case of a foreign insurance company (other than a life or mutual insurance company) and a foreign mutual marine insurance company, the normal-tax net income shall be the net income from sources within the United States minus the credit provided in section 26 (a), the credit provided in section 26 (b), and the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and the corporation surtax net income shall be the net income from sources within the United States minus the credit provided in section 26 (b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e).

(3) *No United States insurance business.* Foreign insurance companies (other than a

life or mutual insurance company) and foreign mutual marine insurance companies not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as other foreign corporations.

(b) *Definition of income, etc.* In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross income.* "Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22;

(2) *Net income.* "Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) *Investment income.* "Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) *Underwriting income.* "Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) *Premiums earned.* "Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. For the purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 201 (c) (2), pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 201 (b);

(6) *Losses incurred.* "Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) *Expenses incurred.* "Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) *Deductions allowed.* In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) *Capital losses.* Capital losses to the extent provided in section 117 plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders in their capacity as such, losses paid, and expenses paid over the sum of interest, dividends, rents, and net premiums received. In the application of section 117 (e) for the purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) the corporation surtax net income (computed without regard to gains or losses from sales or exchanges of capital assets); or

(B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

(6) Debts in the nature of agency balances and bills receivable which become worthless within the taxable year;

(7) The amount of interest earned during the taxable year which under section 22 (b) (4) is excluded from gross income;

(8) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (l);

(9) Charitable, and so forth, contributions, as provided in section 23 (q);

(10) Deductions (other than those specified in this subsection) as provided in section 23;

(11) Dividends and similar distributions paid or declared to policyholders in their capacity as such. The term "paid or declared" shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company.

(d) *Deductions of foreign corporations.* In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States.

(e) *Double deductions.* Nothing in this section shall be construed to permit the same item to be twice deducted.

(f) *Credits under section 26.* For the purposes of this section, in computing normal tax net income and corporation surtax net income, the credits provided in section 26 shall be allowed in the manner and to the extent provided in sections 13 (a) and 15 (a).

§ 29.204–1 *Tax on insurance companies other than life or mutual and mutual marine insurance companies.* All insurance companies (other than life or mutual or foreign insurance companies not carrying on an insurance business within the United States) and all mutual marine insurance companies are subject to the tax imposed by section 204. The term "insurance companies" as used in this section and §§ 29.204–2 and 29.204–3 means only those companies subject to the tax imposed by section 204. For what constituntes an insurance company, see § 29.3797–7. The net income of insurance companies is defined in section 204 and differs from the net income of other corporations. All provisions of the Internal Revenue Code and of these regulations not inconsistent with the specific provisions of section 204 are applicable to the assessment and collection of the tax imposed by section 204 (a), and insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. Since section 204 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the returns under section 204 shall be made on the basis of the calendar year and shall be on Form 1120. Insurance companies are entitled, in computing normal-tax net income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a).

Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 204 but are taxable as other foreign corporations. See section 231.

Insurance companies are subject to both normal tax and surtax. The normal tax shall be at the rate specified in section 13 (b) if the company has a normal-tax net income of more than $25,000, or at the rate specified in section 14 (b) if it has a normal-tax net income of not more than $25,000. For what constitutes normal-tax net income, see § 29.13–1. The surtax shall be at the rate specified in section 15 (b) (1) if the company has a corporation surtax net income of not more than $25,000, at the rate specified in section 15 (b) (2) if it has a corporation surtax net income of more than $25,000 and not more than $50,000, or at the rate specified in section 15 (b) (3) if it has a corporation surtax net income of more than $50,000. For what constitutes corporation surtax net income, see § 29.15–1. For alternative tax where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 117 (c) and the regulations thereunder.

§ 29.204–2 *Gross income of insurance companies other than life or mutual and mutual marine insurance companies.* Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from the sale or other disposition of property,

and all other items constituting gross income under section 22. See section 22 (a), (b), and (c) and sections 28 and 334. It does not include increase in liabilities during the year on account of reinsurance treaties, remittances from the home office of a foreign insurance company to the United States branch, borrowed money, or gross increase due to adjustments in book value of capital assets. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Code. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared to shareholders in their capacity as such, home office remittances and receipts, and special deposits, are ignored. Gain or loss from agency balances and bills receivable not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been allowed as deductions for worthless debts or, having been previously so allowed, are recovered during the taxable year. In computing "premiums earned on insurance contracts during the taxable year" the amount of the unearned premiums shall include (1) life insurance reserves as defined in section 201 (c) (2) and § 29.201–4 pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by section 204 and not qualifying as a life insurance company under section 201 (b), and (2) liability for return premiums under a rate credit or retrospective rating plan based on experience, such as the "War Department Insurance Rating Plan," and which return premiums are therefore not earned premiums. In computing "losses incurred" the determination of unpaid losses at the close of each year must represent actual unpaid losses as nearly as it is possible to ascertain them.

§ 29.204–3 *Deductions allowed insurance companies other than life or mutual marine insurance companies.* The deductions allowable are specified in section 204 (c) and by reason of the provisions of section 204 (c) (10) include deductions (other than those specified in section 204 (c)) as provided in section 23. The deductions, however, are subject to the limitation provided in section 24 (a) (5). The net operating loss deduction allowed by section 23 (s) is computed under section 122 and the regulations thereunder. In computing net operating loss or net income of insurance companies for the purposes of section 122 "gross income" shall mean gross income as defined in section 204 (b) (1) and the allowable deductions shall be those allowed by section 204 (c) with the exceptions and limitations set forth in section 122 (d). In addition to the deduction for capital losses provided in section 117, insurance companies are allowed a deduction for losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. A special rule is provided for the application of the 5-year capital loss carry-over provisions of section 117 (e). The deduction is the same as that allowed mutual insurance companies other than life or marine, see section 207 (b) (4) (F) and the regulations thereunder. Insurance companies are also allowed a deduction for dividends and similar distributions paid or declared to policyholders in their capacity as such. The deduction is the same as that allowed mutual insurance companies other than life or marine, see section 207 (b) (3) and the regulations thereunder.

Among the items which may not be deducted are income and profits taxes imposed by the United States, income and profits taxes imposed by any foreign country or possession of the United States (in cases where the company chooses to claim to any extent a credit for such taxes), taxes assessed against local benefits, decrease during the year due to adjustments in the book value of capital assets, decrease in liabilities during the year on account of reinsurance treaties, dividends paid to shareholders in their capacity as such, remittances to the home office of a foreign insurance company by the United States branch, and borrowed money repaid.

In computing net income of insurance companies, losses sustained during the taxable year from the sale or other disposition of property are deductible subject to the limitation contained in section 117 (d) (1). The graduated percentage reduction of gains and losses contained in section 117 (b) does not apply in the case of insurance companies but they are entitled to the alternative taxes provided in section 117 (c).

SEC. 205. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of a domestic insurance company subject to the tax imposed by section 201, 204, or 207, to the extent provided in the case of a domestic corporation in section 131, and in the case of the tax imposed by section 201 or 204 "net income" as used in section 131 means the net income as defined in this Supplement.

SEC. 206. COMPUTATION OF GROSS INCOME.

The gross income of insurance companies subject to the tax imposed by section 201 or 204 shall not be determined in the manner provided in section 119.

SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE [as amended by sec. 205, Rev. Act 1939; sec. 165 (b), Rev. Act 1942.]

(a) *Imposition of tax.* There shall be levied, collected, and paid for each taxable year upon the income of every mutual insurance company (other than a life or a marine insurance company and other than an interinsurer or reciprocal underwriter) a tax computed under paragraph (1) or paragraph (2) whichever is the greater and upon the income of every mutual insurance company (other than a life or a marine insurance company) which is an interinsurer or reciprocal underwriter, a tax computed under paragraph (3):

(1) If the corporation surtax net income is over $3,000 a tax computed as follows:

(A) *Normal tax.* A normal tax on the normal-tax net income, computed at the rates provided in section 13 or section 14 (b), or 30 per centum of the amount by which the normal-tax net income exceeds $3,000, whichever is the lesser; plus

(B) *Surtax.* A surtax on the corporation surtax net income, computed at the rates provided in section 15 (b), or 20 per centum of the amount by which the corporation surtax net income exceeds $3,000, whichever is the lesser.

(2) If for the taxable year the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policy holders, minus the interest which under section 22 (b) (4) is excluded from gross income, exceeds $75,000, a tax equal to the excess of—

(A) 1 per centum of the amounts so computed, or 2 per centum of the excess of the amount so computed over $75,000, whichever is the lesser, over

(B) the amount of the tax imposed under Subchapter E of Chapter 2.

(3) In the case of an interinsurer or reciprocal underwriter, if the corporation surtax net income is over $50,000 a tax computed as follows:

(A) *Normal tax.* A normal tax on the normal-tax net income, computed at the rates provided in section 13 or section 14 (b), or 48 per centum of the amount by which the normal-tax net income exceeds $50,000, whichever is the lesser; plus

(B) *Surtax.* A surtax on the corporation surtax net income, computed at the rates provided in section 15 (b), or 32 per centum of the amount by which the corporation surtax net income exceeds $50,000, whichever is the lesser.

(4) *Gross amount received over $75,000 but less than $125,000.* If the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) is over $75,000 but less than $125,000, the amount ascertained under paragraph (1), paragraph (2) (A), and paragraph (3) shall be an amount which bears the same proportion to the amount ascertained under such paragraph, computed without reference to this paragraph, as the excess over $75,000 of such gross amount received bears to $50,000.

(5) *Foreign mutual insurance companies other than life or marine.* In the case of a foreign mutual insurance company (other than a life or marine insurance company), the net income shall be the net income from sources within the United States and the gross amount of income from interest, dividends, rents, and net premiums shall be the amount of such income from sources within the United States.

(6) *No United States insurance business.* Foreign mutual insurance companies (other than a life or marine insurance company) not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as other foreign corporations.

(b) *Definition of income, etc.* In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross investment income.* "Gross investment income" means the gross amount of income during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets to the extent provided in section 117;

(2) *Net premiums.* "Net premiums" means gross premiums (including deposits and assesments) written or received on insurance contracts during the taxable year less return premiums and premiums paid or incurred for reinsurance. Amounts returned where the amount is not fixed in the

insurance contract but depends upon the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (3);

(3) *Dividends to policyholders.* "Dividends to policyholders" means dividends and similar distributions paid or declared to policyholders. The term "paid or declared" shall be construed according to the method regularly employed in keeping the books of the insurance company;

(4) *Net income.* The term "net income" means the gross investment income less—

(A) *Tax-free interest.* The amount of interest which under section 22 (b) (4) is excluded for the taxable year from gross income;

(B) *Investment expenses.* Investment expenses paid or accrued during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this subparagraph shall not exceed one-fourth of 1 per centum of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which net income computed without any deduction for investment expenses allowed by this subparagraph, or for tax-free interest allowed by subsection (b) (4) (A), exceeds 3¾ per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(C) *Real estate expenses.* Taxes and other expenses paid or accrued during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid or accrued by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes;

(D) *Depreciation.* A reasonable allowance, as provided in section 23 (l), for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(E) *Interest paid or accrued.* All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this chapter.

(F) *Capital losses.* Capital losses to the extent provided in section 117 plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid over the sum of interest, dividends, rents, and net premiums received. In the application of section 117 (e) for the purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(i) the corporation surtax net income (computed without regard to gains or losses from sales or exchanges of capital assets); or

(ii) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

(c) *Rental value of real estate.* The deduction under subsection (b) (4) (C) or (b) (4) (D) of this section on account of any real estate owned and occupied in whole or in part by a mutual insurance company other than life or marine, shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

(d) *Amortization of premium and accrual of discount.* The gross amount of income during the taxable year from interest, the deduction provided in subsection (b) (4) (A), and the credit allowed against net income in section 26 (a) shall each be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company other than life or marine. Such amortization and accrual shall be determined (1) in accordance with the method regularly employed by such company, if such method is reasonable, and (2) in all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

(e) *Deductions of foreign corporations.* In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States.

(f) *Double deductions.* Nothing in this section shall be construed to permit the same item to be twice deducted.

(g) *Credits under section 26.* For the purposes of this section, in computing normal tax net income and corporations surtax net income, the credits provided in section 26 shall be allowed in the manner and to the extent provided in sections 13 (a) and 15 (a).

§ 29.207–1 *Tax on mutual insurance companies other than life or marine.* All mutual insurance companies other than life or marine (including foreign insurance companies carrying on an insurance business within the United States), not specifically exempt under the provisions of section 101 (11), are subject to the tax imposed by section 207 (a) on their investment income or on their gross income, whichever tax is the greater, except interinsurers and reciprocal underwriters which are taxed only on their investment income. For the alternate tax, in lieu of the tax imposed by section 207 (a) (1) or (3), where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 117 (c) (1) and the regulations thereunder.

The taxable income of mutual insurance companies other than life or marine differs from the taxable income of other corporations. See section 207 (a) (2) and section 207 (b). Such companies are entitled, in computing normal-tax net income and corporation surtax net income, to the credits provided in section 26 in the manner and to the extent provided in sections 13 (a) and 15 (a). The gross amount of income during the taxable year from interest, the deductions under section 207 (b) (4) (A) for wholly tax-exempt interest, and the credit under section 26 (a) for partially tax-exempt interest, are decreased by the appropriate amortization of premiums and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company other than life or marine. See section 207 (d) and § 29.207–6.

All provisions of the Internal Revenue Code and of these regulations not inconsistent with the specific provisions of section 207 are applicable to the assessment and collection of the tax imposed by section 207 (a) and mutual insurance companies other than life or marine are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120M.

Foreign mutual insurance companies other than life or marine not carrying on an insurance business within the United States are not taxable under section 207 (a), but are taxable as other foreign corporations. See section 231.

Mutual insurance companies other than life or marine, except inter-insurers or reciprocal underwriters, with corporation surtax net incomes of over $3,000 or with gross amounts of income from interest, dividends, rents, and net premiums, minus dividends to policyholders, minus wholly tax-exempt interest of over $75,000, are subject to a tax computed under section 207 (a) (1) or section 207 (a) (2) whichever is the greater. The tax under section 207 (a) (1) is computed upon normal tax net income and corporation surtax net income at the rates provided in section 13 or section 14 (b) and in section 15 (b). The tax under section 207 (a) (2) is a tax equal to the excess of 1 percent of the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders, minus wholly tax-exempt interest, over the amount of the tax imposed under subchapter E of chapter 2.

Under section 207 (a) (1), companies with normal-tax net incomes of between $3,000 and $6,153.86, and with corporation surtax net incomes of between $3,000 and $6,000, pay a normal tax, at the rate of 30 percent, and a surtax, at the rate of 20 percent, on that portion of the normal-tax net income and the corporation surtax net income, respectively, in excess of $3,000. Under section 207 (a) (2), companies with gross amounts of income from interest, dividends, rents, and net premiums, minus dividends to policyholders, minus wholly tax-exempt interest, of between $75,000 and $150,000, pay a tax equal to the excess of 2 percent of that portion in excess of $75,000, over the amount of the tax imposed under subchapter E of chapter 2.

Interinsurers and reciprocal underwriters with corporation surtax net in-

comes of over $50,000 are taxed under section 207 (a) (3) upon normal-tax net income and corporation surtax net income at the rates provided in section 13 or section 14 (b) and in section 15 (b). Under section 207 (a) (3) interinsurers and reciprocal underwriters with normal-tax net incomes and corporation surtax net incomes of between $50,000 and $100,000 pay a normal tax, at the rate of 48 percent, and a surtax, at the rate of 32 percent, on that portion of the normal-tax net income and the corporation surtax net income, respectively, in excess of $50,000.

Section 207 (a) (4) provides for an adjustment of the amount computed under section 207 (a) (1), section 207 (a) (2) (A), and section 207 (a) (3) where the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) is over $75,000 and less than $125,000. The adjustment reduces the tax otherwise computed under those sections to an amount which bears the same proportion to such tax as the excess over $75,000 bears to $50,000.

The application of section 207 (a) (1), (2), (3), and (4) may be illustrated by the following examples:

Example (1). The X Company, a mutual casualty insurance company, for the taxable year 1942 has a corporation surtax net income of $3,500 and due to partially tax-exempt interest of $600, a normal-tax net income of $2,900. The gross amount of income of the X Company from interest, dividends, rents, net premiums, minus dividends to policyholders, minus wholly tax-exempt interest is $150,000. Its excess profits net income is $2,900. It is not subject to normal tax under section 207 (a) (1) for the taxable year 1942 as its normal-tax net income does not exceed $3,000. Its surtax is 20 percent of $500 ($3,500–$3,000) or $100, since that amount is less than $350, the surtax computed at the rate provided in section 15 (b). It has no normal tax and, therefore, its total tax under section 207 (a) (1) is the surtax of $100. Its excess profits net income is less than $5,000 and, therefore, there is no excess profits tax and the tax under section 207 (a) (2) is 1 percent of $150,000, or $1,500. Since the tax under section 207 (a) (2) exceeds the tax under section 207 (a) (1), the tax under section 207 (a) is $1,500, namely, that imposed by section 207 (a) (2).

Example (2). If in the above example the normal-tax net income, corporation surtax net income, and excess profits net income were each less than $2,900, the gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) was $90,000 and the gross amount of income from interest, dividends, rents, and net premiums, minus, dividends to policyholders, minus wholly tax-exempt interest was $70,000, the X Company would be required to file an income tax return but due to section 207 (a) no income tax would be imposed.

Example (3). The Y Company, a mutual fire insurance company, for the taxable year 1942 has a normal-tax net income of $6,000, a corporation surtax net income of $7,000, and an adjusted excess profits net income of $1,000. The gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) is $120,000 and the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders, minus wholly tax-exempt interest is $100,000. Under section 207 (a) (1), without application of section 207 (a) (4), the normal tax would be 30 percent of $3,000, or $900 (since this is less than $920, the tax computed at the rates provided in section 14 (b)); and the surtax would be 10 percent of $7,000, or $700 (since this is less than $800, the tax computed at 20 percent of the excess of the surtax net income over $3,000). The combined tax of $1,600 would then be reduced by applying section 207 (a) (4), since the gross receipts are between $75,000 and $125,000. The final tax under section 207 (a) (1) would be 90 percent of $1,600, or $1,440, since the $45,000 (the excess of $120,000 over $75,000) is 90 percent of $50,000. The excess profits tax on the adjusted excess profits net income of $1,000 at the rate of 90 percent is $900 (this being less than the 80 percent limitation under section 710 (a) (1) (B)). Under the provisions of section 710 (a), after applying section 710 (a) (4), the excess profits tax is $810 (90 percent of $900) since $45,000 (the excess of $120,000 over $75,000) is 90 percent of $50,000. Under section 207 (a) (2) (A), without reference to section 207 (a) (4), the tax is 2 percent of $25,000 (the excess of $100,000 over $75,000), or $500, since this is less than $1,000, 1 percent of $100,000. Applying section 207 (a) (4) reduces this to $450, or 90 percent of $500. Since $450 is less than the amount of the excess profits tax of $810 there is no tax under section 207 (a) (2) and the tax under section 207 (a) (1) is applicable. The Y Company would accordingly pay a combined normal tax and surtax of $1,440 and an excess profits tax of $810 or a total of $2,250.

Example (4). The Z Exchange, an interinsurer, for the taxable year 1942 has a corporation surtax net income of $60,000 and, due to partially tax-exempt interest of $12,000, a normal-tax net income of $48,000. The gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) is $2,700,000. The Z Exchange is not subject to normal tax under section 207 (a) (3) for the taxable year 1942 as its normal-tax net income is less than $50,000. Its surtax is 32 percent of $10,000 ($60,000–$50,000) or $3,200, since that amount is less than $9,600, the surtax computed at the rate provided in section 15 (b). Since it has no normal tax and is not subject to the tax imposed by section 207 (a) (2) nor entitled to the adjustment provided in section 207 (a) (4), its total tax under section 207 (a) is $3,200.

§ 29.207–2 *Net premiums.* Net premiums are one of the items used, together with interest, dividends, and rents, less dividends to policyholders and wholly tax-exempt interest, in determining tax liability under section 207 (a) (2). They are also used in section 207 (b) (4) (F) in determining the limitation on certain capital losses and in the application of section 117 (e). The term "net premiums" is defined in section 207 (b) (2) and includes deposits and assessments, but excludes amounts returned to policyholders which are treated as dividends under section 207 (b) (3).

§ 29.207–3 *Dividends to policyholders.* "Dividends to policyholders" is one of the deductions used, together with wholly tax-exempt interest, in determining tax liability under section 207 (a) (2). They are also used in section 207 (b) (4) (F) in determining the limitation on certain capital losses and in the application of section 117 (e). The term "dividends to policyholders" is defined in section 207 (b) (3) as dividends and similar distributions paid or declared to policyholders. It includes amounts returned to policyholders where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management. Such amounts are not to be treated as return premiums under section 207 (b) (2). Similar distributions include such payments as the so-called unabsorbed premium deposits returned to policyholders by factory mutual fire insurance companies. The term "paid or declared" is to be construed according to the method of accounting regularly employed in keeping the books of the insurance company, and such method shall be consistently followed with respect to all deductions (including dividends and similar distributions to policyholders) and all items of income.

If the method of accounting so employed is the cash receipts and disbursements method, the deduction is limited to the dividends and similar distributions actually paid to policyholders in the taxable year. If, on the other hand, the method of accounting so employed is the accrual method, the deduction, or a reasonably accurate estimate thereof, for dividends and similar distributions declared to policyholders for any taxable year will, in general, be computed as follows:

To dividends and similar distributions paid during the taxable year add the amount of dividends and similar distributions declared but unpaid at the end of the taxable year and deduct dividends and similar distributions declared but unpaid at the beginning of the taxable year.

If an insurance company on the accrual basis does not use the above method in determining the deduction for dividends and similar distributions declared to policyholders, it must submit with its return a full and complete explanation of the method actually used. For the rule as to when dividends are considered paid, see § 29.27 (b)–2 (a).

§ 29.207–4 *Net income and deductions.* —(a) *In general.* The net income of a mutual insurance company other than life or marine is its gross investment income, namely, the gross amount of income during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets to the extent provided in section 117, less the deductions provided in section 207 (b) (4) for wholly tax-exempt interest, investment expenses, real estate expenses, depreciation, interest paid or accrued, and capital losses. In addition to the limitations on deductions relating to real estate owned and occupied by a mutual insurance company other than life or marine provided in section 207 (c), the adjustment for amortization of premium and accrual of discount provided in section 207 (d), and the limitation on the deduction for investment expenses where general expenses are allocated to investment income provided in section 207 (b) (4) (B), mutual insurance companies other than life or marine are subject to the limitation on deductions relating to wholly tax-exempt

income provided in section 24 (a) (5). Such companies are not entitled to the net operating loss deduction provided in section 23 (s).

(b) *Wholly tax-exempt interest.* Interest which in the case of other taxpayers is excluded from gross income by section 22 (b) (4) but included in the gross investment income of a mutual insurance company other than life or marine by section 207 (b) (1) is allowed as a deduction from gross investment income by section 207 (b) (4) (A).

(c) *Investment expenses.* The deduction allowed by section 207 (b) (4) (B) for investment expenses is the same as that allowed life insurance companies by section 201 (c) (7) (B) except that provision is made for both the cash and accrual method of accounting. (See § 29.201–7 (c).)

(d) *Taxes and expenses with respect to real estate.* The deduction allowed by section 207 (b) (4) (C) for taxes and expenses with respect to real estate owned by the company is the same as that allowed life insurance companies by section 201 (c) (7) (C) except that provision is made for both the cash and accrual method of accounting. (See § 29.201–7 (d).)

(e) *Depreciation.* The deduction allowed by section 207 (b) (4) (D) for depreciation is the same as that allowed life insurance companies by section 201 (c) (7) (D). (See § 29.201–7 (e).)

(f) *Interest paid or accured.* The deduction allowed by section 207 (b) (4) (E) for interest on indebtedness is the same as that allowed other corporations by section 23 (b). (See § 29.23 (b)–1.)

(g) *Capital losses.* The deduction for capital losses under section 207 (b) (4) (F) includes not only capital losses to the extent provided in section 117 but in addition thereto losses from capital assets sold or exchanged to provide funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Losses in the latter case may be deducted from ordinary income while the deduction for losses under section 117 is limited to the gains. (See § 117 (d) (1).)

Capital assets are considered as sold or exchanged to provide for the funds or payments specified in section 207 (b) (4) (F), to the extent that the gross receipts from the sale or exchange of such assets are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, and losses and expenses paid over the sum of interest, dividends, rents, and net premiums received. If, by reason of a particular sale or exchange of a capital asset, gross receipts are greater than such excess, the gross receipts and the resulting loss should be apportioned and the excess included in capital losses subject to the provision of section 117. Capital losses actually used to reduce net income in any taxable year may not again be used in a succeeding taxable year as an offset against capital gains in that year and for that purpose a special rule is set forth for the application of section 117 (e).

The application of section 207 (b) (4) (F) may be illustrated by the following examples:

Example (1). The X Company, a mutual fire insurance company, in the taxable year 1942 sells capital assets in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. The gross receipts from the sale are $60,000, resulting in losses of $20,000. It pays dividends to policyholders of $150,000, losses of $25,000, and expenses of $25,000. It receives interest of $50,000, dividends of $5,000, rents of $4,000, and net premiums of $66,000. The excess of the sum of dividends, losses and expenses paid ($200,000) over the sum of interest, dividends, rents, and net premiums received ($125,000) is $75,000. As the gross receipts from the sale of capital assets ($60,000) do not exceed such excess ($75,000), the losses of $20,000 are allowable as a deduction from gross investment income.

Example (2). If in the above example the gross receipts were $76,000 and the last capital asset sold, for the purpose therein specified, resulted in gross receipts of $2,000 and a loss of $500, the losses allowable as a deduction from gross investment income would be $19,750. The last sale made the gross receipts of $76,000 exceed by $1,000 the excess ($75,000) of the sum of dividends, losses, and expenses paid ($200,000) over the sum of interest, dividends, rents, and net premiums received ($125,000). The gross receipts and the resulting loss from the last sale is apportioned on the basis of the ratio of the excess of $1,000 to the gross receipts of $2,000, or 50 percent. Fifty percent of the loss of $500 is deducted from the total loss of $20,000. The remaining gross receipts of $1,000 and the proportionate loss of $250 should be reported as capital losses under section 117.

Example (3). If in example (1) the X Company had a corporation surtax net income of $9,750 and, under the provisions of section 117, had capital losses of $18,000 and capital gains of $10,000, the net capital loss for the taxable year 1942 in applying section 117 (e) for the purposes of section 207 (b) (4) (F), would be $8,000. This is determined by subtracting from total losses of $38,000 ($18,000 capital losses under section 117 plus $20,000 other capital losses under section 207 (b) (4) (F)) the sum of capital gains of $10,000 and losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders of $20,000. Such losses of $20,000 are added to capital gains of $10,000, since they are less than corporation surtax net income, computed without regard to gains or losses from sales or exchanges of capital assets, of $29,750 ($9,750 corporation surtax net income plus $20,000 other capital losses under section 207 (b) (4) (F) plus the portion of capital losses allowable under section 117 of $10,000 minus capital gains under section 117 of $10,000).

§ 29.207–5 *Real estate owned and occupied.* The limitation in section 207 (c) on the amount allowable as a deduction for taxes, expenses, and depreciation upon or with respect to any real estate owned and occupied in whole or in part by a mutual insurance company other than life or marine is the same as that provided in the case of life insurance companies by section 201 (d). (See § 29.201–8.)

§ 29.207–6 *Amortization of premium and accrual of discount.* Section 207 (d) makes provision for the appropriate amortization of premium and the appropriate accrual of discount, attributable to the taxable year, on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company other than life or marine. Such amortization and accrual is the same as that provided for life insurance companies by section 201 (e) and shall be determined in accordance with the regulations thereunder, see § 29.201–9, except that in determining the premium and discount of a mutual insurance company other than life or marine the basis provided in section 113 shall be used in lieu of the acquisition value.

NONRESIDENT ALIEN INDIVIDUALS

SEC. 211. TAX ON NONRESIDENT ALIEN INDIVIDUALS [as amended by sec. 109 (b) (c), Rev. Act 1941; secs. 106 (a) (b) (c), 160 (d) (e), 167, Rev. Act 1942.]

(a) *No United States business or office*—(1) *General rule*—(A) *Imposition of tax.* There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 11 and 12, upon the amount received, by every nonresident alien individual not engaged in trade or business within the United States, from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or terminable annual or periodical gains, profits, and income, a tax of 30 per centum of such amount, except that such rate shall be reduced, in the case of a resident of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, to such rate (not less than 5 per centum) as may be provided by treaty with such country. [For rate of 27½ percent prior to October 31, 1942, in lieu of 30 percent, see sec. 106 (a), Rev. Act 1942, set forth below.]

(B) *Cross reference.* For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(2) *Aggregate more than $15,400.* The tax imposed by paragraph (1) shall not apply to any individual if the aggregate amount received during the taxable year from the sources therein specified is more than $15,400.

(3) *Residents of certain countries.* The provisions of paragraph (2) shall not apply to a resident of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, so long as there is in effect with such country a treaty which provides otherwise.

(b) *United States business or office.* A nonresident alien individual engaged in trade or business in the United States shall be taxable without regard to the provisions of subsection (a). As used in this section, section 119, section 143, section 144, and section 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include the performance of personal services for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such phrase does not include the effecting, through a resident broker, commission agent, or custodian, of transactions in the United States in commodities (if of a kind customarily dealt in on an organized

commodity exchange, if the transaction is of the kind customarily consummated at such place, and if the alien, partnership, or corporation has no office or place of business in the United States at any time during the taxable year through which or by the direction of which such transactions in commodities are effected), or in stocks or securities.

(c) *No United States business or office and gross income of more than $15,400.* A nonresident alien individual not engaged in trade or business within the United States who has a gross income for any taxable year of more than $15,400 from the sources specified in subsection (a) (1), shall be taxable without regard to the provisions of subsection (a) (1), except that—

(1) The gross income shall include only income from the sources specified in subsection (a) (1);

(2) The deductions (other than the so-called "charitable deduction" provided in section 213 (c)) shall be allowed only if and to the extent that they are properly allocable to the gross income from the sources specified in subsection (a) (1);

(3) The aggregate of the normal and surtax under sections 11 and 12 shall, in no case, be less than 30 per centum of the gross income from the sources specified in subsection (a) (1); and

(4) This subsection shall not apply to a resident of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, so long as there is in effect with such country a treaty which provides otherwise. [For rate of 27½ percent prior to October 31, 1942, in lieu of 30 percent, see sec. 106 (c), Rev. Act 1942, set forth below.]

SEC. 106. TAX ON NONRESIDENT ALIEN INDIVIDUALS. (Revenue Act of 1942, Title I.)

(a) *Tax in general.* Section 211 (a) (1) (A) (relating to tax on nonresident alien individuals not engaged in trade or business within the United States) is amended by striking out "27½ per centum" and inserting in lieu thereof "30 per centum". The amendments made by this subsection shall apply with respect to amounts received after the ninth day after the date of the enactment of this Act regardless of whether the taxable year of the recipient begins before January 1, 1942, or after December 31, 1941.

* * * * *

(c) *Tax where gross income of more than $15,400.* Section 211 (c) (relating to tax on certain nonresident alien individuals) is amended by striking out "$23,000" wherever occurring therein and inserting in lieu thereof "$15,400"; and by striking out "27½" per centum" and inserting in lieu thereof "30 per centum". In the application of the amendments made by this subsection, the rate shall be 27½ per centum with respect to the period ending with the ninth day after the date of the enactment of this Act and shall be 30 per centum with respect to the period after such day.

SEC. 109. TREATY OBLIGATIONS. (Revenue Act of 1942, Title I.)

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States.

§ 29.211–1 *Taxation of aliens in general.* For the purposes of chapter 1 alien individuals are divided generally into two classes, namely, resident aliens and nonresident aliens. Resident aliens are in general taxable the same as citizens of the United States, that is, a resident alien is taxable on income derived from all sources including sources without the United States. Nonresident aliens are taxable only on income from sources within the United States. For classification of nonresident aliens, see § 29.211–7.

§ 29.211–2 *Definition.* A "nonresident alien individual" means an individual:

(a) Whose residence is not within the United States; and

(b) Who is not a citizen of the United States.

The term includes a nonresident alien fiduciary.

An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.

§ 29.211–3 *Alien seamen, when to be regarded as residents.* In order to determine whether an alien seaman is a resident within the meaning of chapter 1, it is necessary to decide whether the presumption of nonresidence is overcome by facts showing that he has established a residence in the United States. Residence may be established on a vessel regularly engaged in coastwise trade, but the mere fact that a sailor makes his home on a vessel flying the United States flag and engaged in foreign trade is not sufficient to establish residence in the United States, even though the vessel, while carrying on foreign trade, touches at American ports. An alien seaman may acquire an actual residence in the United States within the rules laid down in § 29.211–4, although the nature of his calling requires him to be absent for a long period from the place where his residence is established. An alien seaman may acquire such a residence at a sailors' boarding house or hotel, but such a claim should be carefully scrutinized in order to make sure that such residence is bona fide. The filing of Form 1078 or taking out first citizenship papers is proof of residence in the United States from the time the form is filed or the papers taken out, unless rebutted by other evidence showing an intention to be a transient. The fact that a head tax has been paid on behalf of an alien seaman entering the United States is no evidence that he has acquired residence, because the head tax is payable unless the alien who is entering the country is merely in transit through the country.

§ 29.211–4 *Proof of residence of alien.* The following rules of evidence shall govern in determining whether or not an alien within the United States has acquired residence therein within the meaning of chapter 1. An alien, by reason of his alienage, is presumed to be a nonresident alien. Such presumption may be overcome:

(a) In the case of an alien who presents himself for determination of tax liability prior to departure for his native country, by (1) proof that the alien, at least six months prior to the date he so presents himself, has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (2) proof that the alien, at least six months prior to the date he so presents himself, has filed Form 1078 or its equivalent, or (3) proof of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident;

(b) In other cases by (1) proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (2) proof that the alien has filed Form 1078 or its equivalent, or (3) proof of acts and statements of an alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident.

In any case in which an alien seeks to overcome the presumption of nonresidence under paragraph (a) (3) or (b) (3), if the internal-revenue officer who examines the alien is in doubt as to the facts, such officer may, to assist him in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some credible person or persons, other than the alien and members of his family, who have known the alien at least six months prior to the date of execution of the affidavit or affidavits.

§ 29.211–5 *Loss of residence by alien.* An alien who has acquired residence in the United States retains his status as a resident until he abandons the same and actually departs from the United States. An intention to change his residence does not change his status as a resident alien to that of a nonresident alien. Thus, an alien who has acquired a residence in the United States is taxable as a resident for the remainder of his stay in the United States.

§ 29.211–6 *Duty of employer to determine status of alien employee.* If wages are paid to aliens without withholding the tax, except as permitted in § 29.143–3, in the case of a resident of Canada or Mexico, the employer should be prepared to prove the status of the alien as provided in §§ 29.211–1 to 29.211–5, inclusive. An employer may rely upon the evidence of residence afforded by the fact that an alien has filed Form 1078, or an equivalent certificate of the alien establishing residence. An employer need not secure Form 1078 from the alien if he is

satisfied that the alien is a resident alien. An employer who seeks to account for failure to withhold in the past, if he had not at the time secured Form 1078 or its equivalent, is permitted to prove the former status of the alien by any competent evidence. The written statement of the alien employee may ordinarily be relied upon by the employer as proof that the alien is a resident of the United States.

§ 29.211–7 *Taxation of nonresident alien individuals.* For the purposes of this section and §§ 29.212–1, 29.213–1, 29.214–1, 29.215–1, and 29.217–2, nonresident alien individuals are divided into three classes: (1) Nonresident alien individuals not engaged in trade or business within the United States at any time during the taxable year and deriving in the taxable year not more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United State; (2) nonresident alien individuals not engaged in trade or business within the United States at any time during the taxable year and deriving in the taxable year more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United States; and (3) nonresident alien individuals who at any time during the taxable year are engaged in trade or business in the United States.

(a) *No United States business; general rule.* A nonresident alien individual within class (1), referred to in the preceding paragraph, is liable to the tax upon the amount received from sources within the United States, determined under the provisions of section 119, which is fixed or determinable annual or periodical gains, profits, and income. For the purposes of section 211 (a), the term "amount received" means "gross income." Specific items of fixed or determinable annual or periodical income are enumerated in the Internal Revenue Code as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensation, remunerations, and emoluments, but other fixed or determinable annual or periodical gains, profits, and income are also subject to the tax, as for instance, royalties. As to the determination of fixed or determinable annual or periodical income, see § 29.143–2. The items of fixed or determinable annual or periodical income from sources within the United States received by a citizen of France residing in France which are exempt from Federal income taxation under the provisions of the tax convention between the United States and France, signed April 27, 1932, and effective January 1, 1936 (See Part 13 of this chapter), are described in § 29.143–3. As to items of such income received on or after January 1, 1940, by individual residents of Sweden or by Swedish corporations or other Swedish entities and exempt from Federal income taxation, see the tax convention between the United States and Sweden, effective January 1, 1940, and the regulations thereunder (see Part 25 of this chapter). Under the provisions of the tax convention between the United States and Canada (ratifications exchanged June 15, 1942) certain annuities and pensions received on and after January 1, 1941, by individual residents of Canada are exempt from tax.

The fixed or determinable annual or periodical income from sources within the United States of a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year and deriving in the taxable year not more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United States is taxable at the rate of 30 percent as to such income received on and after October 31, 1942 (27½ percent as to such income received before October 31, 1942), except that such rate shall be reduced, in the case of a resident of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, to such rate (not less than 5 percent) as may be provided by treaty with such country. (See also § 29.212–1.) Under the provisions of the tax convention between the United States and Canada (ratifications exchanged June 15, 1942) and effective January 1, 1941, the tax rates of 27½ percent or 30 percent, as the case may be, otherwise imposed by section 211 (a), were reduced to 15 percent as to items of income received on or after April 30, 1941, in the case of a nonresident alien individual who is a resident of Canada (see §§ 7.10 to 7.17, inclusive, of this chapter [1]).

(b) *No United States business; aggregate more than $15,400.* A nonresident alien individual within class (2), referred to in the first paragraph of this section, is under the provisions of section 211 (c), subject to tax only upon his fixed or determinable annual or periodical income specified in section 211 (a) determined under the provision of section 119, minus (1) the deductions properly allocable to such income and (2) the so-called "charitable contributions" deduction provided in section 213 (c). Such nonresident alien is entitled to the credits against net income allowable to an individual by section 25, subject to the limitations provided in section 214. However, the tax thus computed under sections 11 and 12 shall in no such case be less than 30 percent (27½ percent prior to October 31, 1942) of the gross amount of such fixed or determinable annual or periodical income from sources within the United States. Nonresident aliens within class (2) (other than residents of Canada) are also subject to the victory tax imposed by section 450. A nonresident alien, a resident of Canada, within class (2) is not subject to the provisions of section 211 (c) or of this section but is subject to taxation as set forth in paragraph (a) of this section regardless of the amount of his fixed or determinable annual or periodical income from sources within the United States (see §§ 7.10 to 7.17, inclusive, of this chapter [1]).

(c) *United States business.* A nonresident alien individual within class (3) referred to in the first paragraph of this section, is not taxable at the rate of 30 percent (27½ percent prior to October 31, 1942) upon the items of gross income enumerated in section 211 (a). The net income from sources within the United States of such a nonresident alien individual (gross income from sources within the United States minus the statutory deductions provided in sections 23 and 213) less the credits against net income allowable to an individual by section 25, is subject to the normal tax of 6 percent imposed by section 11, the graduated surtax imposed by section 12 (b), and the victory tax imposed by section 450.

As used in sections 119, 143, 144, 211, and 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year but does not include the performance of personal services for a nonresident alien individual, foreign partnership, or foreign corporation not engaged in trade or business within the United States by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian. (See also § 29.212–1.) The term "commodities" as used in section 211 (b) means only goods of a kind customarily dealt in on an organized commodity exchange, such as a grain futures or a cotton futures market, and does not include merchandise in the ordinary channels of commerce.

Neither the beneficiary nor the grantor of a trust, whether revocable or irrevocable, is deemed to be engaged in trade or business in the United States merely because the trustee is engaged in trade or business in the United States.

SEC. 212. GROSS INCOME.

(a) *General rule.* In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States.

(b) *Ships under foreign flag.* The income of a nonresident alien individual which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States shall not be included in gross income and shall be exempt from taxation under this chapter.

§ 29.212–1 *Gross income of nonresident alien individuals.* In general, in the case of nonresident alien individuals "gross income" means only the gross income from sources within the United States, determined under the provisions of section 119. (See §§ 29.119–1 to 29.119–14, inclusive.) The items of gross income from sources without the United States and therefore not taxable to nonresident aliens are described in section 119 (c). As to who are nonresident alien individuals, see §§ 29.211–2 to 29.211–6, inclusive.

Income received by a resident alien from sources without the United States is taxable although such person may be-

[1] 7 F.R. 4825.

come a nonresident alien subsequent to its receipt and prior to the close of the taxable year. Conversely, income received by a nonresident alien from sources without the United States is not taxable though such person may become a resident alien subsequent to its receipt and prior to the close of the taxable year.

(a) *No United States business.* The gross income of a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year, whether such alien comes within section 211 (a) or section 211 (c), is gross income from sources within the United States consisting of fixed or determinable annual or periodical income. His taxable income does not include profits derived from the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian, or profits derived from the sale within the United States of personal property or real property located therein.

(b) *United States business.* The gross income of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States is not limited to the items of gross income specified in section 211 (a), but includes any item of gross income which is treated as income from sources within the United States, except those items which are exempt from taxation by statute or treaty or which are not taxable by the Federal Government under the Constitution. (See sections 22 (b), 112, 116, 119, and 212 (b).)

In general, any nonresident alien individual who performs personal services within the United States is considered as being engaged in trade or business within the United States and therefore his net income from sources within the United States, including his compensation, is subject to the normal tax of 6 percent, the surtax, and the victory tax. However, the phrase "engaged in trade or business within the United States" does not apply to the personal services performed within the United States for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such compensation is not income from sources within the United States. (See section 119 (a) (3).) As to the exclusion from gross income of the official compensation received by employees of foreign governments, see section 116 (h).

The effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian does not bring a nonresident alien individual within the class of nonresident alien individuals engaged in trade or business within the United States, but if a nonresident alien individual by reason of rendering personal services in the United States, or for other reasons, is classed as a nonresident alien individual engaged in trade or business within the United States, he is taxable upon all income from sources within the United States, including profits derived from the effecting of such transactions. Such a nonresident alien individual is required to include in gross income capital gains, gains from hedging transactions, and profits derived from the sale within the United States of personal property, or of real property located therein. The term "commodities" as used in section 211 (b) means only goods of a kind customarily dealt in on an organized commodity exchange, such as a grain futures or a cotton futures market, and does not include merchandise in the ordinary channels of commerce.

§ 29.212–2 *Exclusion of earnings of foreign ships from gross income.* So much of the income from sources within the United States of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States nonresident in such foreign country and to corporations organized in the United States, shall not be included in gross income. Foreign countries which either impose no income tax, or, in imposing such tax, exempt from taxation so much of the income of a citizen of the United States nonresident in such foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States are considered as granting an equivalent exemption within the meaning of this section.

A nonresident alien individual not engaged in trade or business within the United States at any time within the taxable year is not required to include in gross income such income from sources within the United States as is derived from the operation of a ship or ships, whether or not the foreign country under the laws of which such ships are documented meets the equivalent exemption requirement of the Internal Revenue Code.

SEC. 213. DEDUCTIONS.

(a) *General rule.* In the case of a nonresident alien individual the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in section 119, under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(b) *Losses.* (1) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 23 (e) (2) shall be allowed whether or not connected with income from sources within the United States, but only if the profit, if such transaction had resulted in a profit, would be taxable under this chapter.

(2) The deduction for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 23 (e) (3), shall be allowed whether or not connected with income from sources within the United States, but only if the loss is of property within the United States.

(c) *Charitable, etc., contributions.* The so-called "charitable contribution" deduction allowed by section 23 (o) shall be allowed whether or not connected with income from sources within the United States, but only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States, or to the vocational rehabilitation fund.

§ 29.213–1 *Deductions allowed nonresident alien individuals*—(a) *No United States business*—(1) *General rule.* In general, a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year is not allowed any deductions, the tax being imposed upon the amount of gross income received.

(2) *Aggregate more than $15,400.* A nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States at any time during the taxable year and deriving for such year more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United States is allowed for such year only such deductions as are properly allocable to such income. He is also allowed the contributions or gifts made within the taxable year whether or not connected with income from sources within the United States but only if made to domestic corporations or to community chests, funds, or foundations created in the United States of the type specified in section 23 (o), or to the vocational rehabilitation fund, subject to the limitations provided in section 23 (o).

(b) *United States business.* In the case of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States the deductions allowed by section 23 for business expenses, interest, taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the United States. (See also section 215.) In the case of such taxpayers, however, (1) losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, although not connected with the trade or business, are (if otherwise allowable) deductible only if and to the extent that the profit, if such transaction had resulted in a profit, would have been taxable as income from sources within the United States; (2) losses sustained during the taxable year of property not connected with the trade or business if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise, are deductible only if the property

was located within the United States; and (3) contributions or gifts made within the taxable year are deductible, only if made to domestic corporations or to community chests, funds, or foundations created in the United States of the type specified in section 23 (o), or to the vocational rehabilitation fund, subject to the limitation provided in section 23 (o).

Losses embraced under paragraph (a) (2) of this section are deductible in full from items of gross income specified as being derived in full from sources within the United States, and, if greater than the sum of such items, the unabsorbed loss may be deducted from the income apportioned to sources within the United States under the provisions of § 29.119–12. Losses embraced under paragraph (a) (1) are deductible in full (as provided in § 29.119–10 or § 29.119–11) when the profit from the transaction, if it had resulted in a profit, would have been taxable in full as income from sources within the United States, but should be deducted under the provisions of § 29.119–12 when the profit from the transaction, if it had resulted in profit, would have been taxable only in part.

SEC. 214. CREDITS AGAINST NET INCOME [as amended by sec. 6 (b), Rev. Act 1940; sec. 111 (b), Rev. Act 1941; sec. 131 (a), Rev. Act 1942].

In the case of a nonresident alien individual the personal exemption allowed by section 25 (b) (1) of this chapter shall, except as hereinafter provided in the case of a resident of a contiguous country, be only $500. In the case of a nonresident alien individual residing in a contiguous country who is married and living with husband or wife or who is the head of a family, the personal exemption shall be that specified in section 25 (b) if such contingous country allows to citizens of the United States not residing in such country who are married and living with husband or wife and to citizens of the United States not residing in such country who are heads of families the same personal exemption as that allowed citizens of such country who are married and living with husband or wife or who are heads of families, as the case may be. The credit for dependents allowed by section 25 (b) (2) shall not be allowed in the case of a nonresident alien individual unless he is a resident of a contiguous country.

§ 29.214–1 *Credits to nonresident alien individuals*—(a) *No United States business*—(1) *General rule.* In general, a nonresident alien individual not engaged in trade or business in the United States at any time during the taxable year is not allowed any credits under section 25, the tax being imposed upon the amount of gross income received.

(2) *Aggregate more than $15,400.* In the case of a nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States at any time during the taxable year and deriving in such year gross amount of fixed or determinable annual or periodical income from sources within the United States or more than $15,400, the credits allowed are those applicable in the case of nonresident alien individuals engaged in trade or business within the United States.

(b) *United States business.* In the case of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States, the personal exemption allowed as a credit against net income by section 25 (b) (1) shall, except in the case of a resident of a contiguous country, be $500, whether such alien is a single person, a married person living with husband or wife, or the head of a family. However, in the case of a resident of Canada or Mexico the same personal exemption as in the case of a citizen of the United States applies on the basis of reciprocity. If, therefore, it is established to the satisfaction of the Commissioner that the individual is married and living with husband or wife or is the head of a family, as the case may be, the personal exemption pertaining to such status will be applicable, provided that the country of which the individual is a resident, allows a citizen of the United States not residing in such country, and who is married and living with husband or wife or is the head of a family, the same personal exemption as is allowed by such country to its own citizens who occupy such status. The credit for dependents provided by section 25 (b) (2) is allowed to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States only if they are residents of Canada or Mexico. If the status of the taxpayer as to dependents changes during the taxable year, the credit for dependents shall be determined as provided in § 29.25–7.

SEC. 215. ALLOWANCE OF DEDUCTIONS AND CREDITS.

(a) *Return to contain information.* A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this chapter only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources in the United States, in the manner prescribed in this chapter; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(b) *Tax withheld at source.* The benefit of the personal exemption and credit for dependents may, in the discretion of the Commissioner and under regulations prescribed by him with the approval of the Secretary, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

§ 29.215–1 *Allowance of deductions and credits to nonresident alien individuals*—(a) *No United States business*—(1) *General rule.* In general, a nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year is not entitled to any allowance of deductions or credits even though he may file a return of income.

(2) *Aggregate more than $15,400.* Unless a nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States at any time during the taxable year and having, for such year from sources within the United States, fixed or determinable annual or periodical income in a gross amount of more than $15,400 shall file or cause to be filed with the collector a true and accurate return of his total fixed or determinable annual or periodical income from sources within the United States as required by paragraph (a) (2) of § 29.217–2, the tax shall be collected on the basis of gross amount of such fixed or determinable annual or periodical income. Where such nonresident alien has various sources of fixed or determinable annual or periodical income from within the United States, as, for instance, from an estate or trust, from stocks or bonds held directly by him, or from securities held for him by a custodian resident in the United States, so that his total gross fixed or determinable annual or periodical income from United States sources is in excess of $15,400 and a return of income is not filed by him or on his behalf, the Commissioner will cause a return of income to be made and include therein the fixed or determinable annual or periodical income from all sources within the United States concerning which he has information without allowance for deductions and credits, and will assess the tax and collect it from one or more of the sources of income within the United States. Such nonresident alien shall make or have made a full and accurate return on Form 1040NB–a of all his fixed or determinable annual or periodical income from sources within the United States. As to the duty of the representative or agent of such alien to file the return and pay the tax, see paragraph (b) of § 29.217–2, which is hereby made equally applicable in the case of a nonresident alien individual coming within the provisions of this paragraph.

(b) *United States business.* Unless a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States shall file, or cause to be filed, with the collector, a true and accurate return of his total income from sources within the United States, as required by paragraph (b) of § 29.217–2, the tax shall be collected on the basis of the gross income (not the net income) from sources within the United States. Where such a nonresident alien has various sources of income within the United States, so that his total income calls for the assessment of a surtax, and a return of income was not filed by him or on his behalf, the Commissioner will cause a return of income to be made and include therein the income of such nonresident alien from all sources concerning which he has information, without allowance for deductions or credits, and will assess the tax and collect it from one or more of the sources of income of such nonresident alien within the United States.

SEC. 216. CREDITS AGAINST TAX [as amended by sec. 504, 2d Rev. Act. 1940].

A nonresident alien individual shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131. A nonresident alien individual shall be allowed as a credit against his tax the amount required by section 396 to be paid by the personal service corporation of which he is a shareholder

with respect to his tax liability under Supplement S.

SEC. 217. RETURNS [as amended by sec. 5 (e), Current Tax Payment Act 1943.]

(a) *Requirement.* In the case of a nonresident alien individual with respect to whose wages, as defined in section 1621 (a), withholding under Subchapter D of Chapter 9 is not made applicable, the return, in lieu of the time prescribed in section 53 (a) (1), shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then on or before the fifteenth day of June. [NOTE.—The amendment of this provision by sec. 5 (a), Current Tax Payment Act 1943, is, under sec. 5 (f) thereof, effective with respect to taxable years beginning after December 31, 1942. Such amendment added the words "with respect to * * * made applicable".]

(b) *Exemption from requirement.* Subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Commissioner, with the approval of the Secretary, nonresident alien individuals subject to the tax imposed by section 211 (a) may be exempted from the requirement of filing returns of such tax.

§ 29.217–1 *Time and place for filing returns of nonresident alien individuals.* The return in the case of a nonresident alien individual must be made on or before the 15th day of the sixth month following the close of the fiscal year or on before the 15th day of June, if on the basis of the calendar year. For provisions relating to certain cases in which the time for filing the return is postponed by reason of the war, see Part 472 of this chapter. The return must be filed with the collector of internal revenue for the district in which the nonresident alien individual has his principal place of business in the United States, or if he has no principal place of business in the United States, then with the collector of internal revenue at Baltimore, Md. For failure to make and file return within the time prescribed, see section 291. For cases in which no return is required, see paragraph (a) of § 29.217–2.

§ 29.217–2 *Return of income*—(a) *No United States business*—(1) *General rule.* If the tax liability of a nonresident alien individual, not engaged in trade or business within the United States at any time during the taxable year, is fully satisfied at the source a return of income is not required. A nonresident alien individual not engaged in trade or business within the United States at any time during the taxable year shall make or have made a return on Form 1040NB with respect to that portion of his income received from sources within the United States consisting of interest on so-called tax-free covenant bonds on which a tax of only 2 percent was withheld at the source, and with respect to any other fixed or determinable annual or periodical income upon which the tax was not fully satisfied at the source, including dividends received from a foreign corporation which are treated as income from sources within the United States under section 119 (a) (2) (B), and shall pay the balance of the tax shown to be due.

(2) *Aggregate more than $15,400.* A nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States at any time during the taxable year deriving in such year more than $15,400 gross amount of fixed or determinable annual or periodical income from sources within the United States, shall make or have made a full and accurate return on Form 1040NB–a of all his fixed or determinable annual or periodical income from sources within the United States. Such return need not disclose profits derived from the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian, or profits derived from the sale within the United States of personal property or real property located therein. As to the duty of the representative or agent of such alien to file the return and pay the tax, see paragraph (b) of this section, which is hereby made equally applicable in the case of a nonresident alien coming within the provisions of this paragraph.

(b) *United States business.* If a nonresident alien individual at any time within the taxable year is engaged in trade or business within the United States, he shall make or have made a full and accurate return on Form 1040B of his income received from all sources within the United States. A return will not be required, however, in the case of such a nonresident alien individual, a resident of Canada or Mexico, whose sole income from sources within the United States consists of compensation for personal services and does not exceed $500 during the taxable year.

The responsible representative or agent within the United States of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States shall make in behalf of his nonresident alien principal, a return of, and shall pay the tax on, all income from sources within the United States coming within his control as representative or agent. The agency appointed will determine how completely the agent is substituted for the principal for tax purposes. See § 29.51–2. Any person who collects interest or dividends on deposited securities of such a nonresident alien, executes ownership certificates in connection therewith and sells such securities under special instructions shall not be deemed merely by reason of such acts to be the responsible representative or agent of the nonresident alien. Where upon filing a return of income it appears that such a nonresident alien is not liable for tax, but nevertheless a tax shall have been withheld at the source, in order to obtain a refund on the basis of the showing made by the return there should be attached to it a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents. (See § 29.143–4.)

SEC. 218. PAYMENT OF TAX [as amended by sec. 5 (e), Current Tax Payment Act 1943].

(a) *Time of payment.* In the case of a nonresident alien individual with respect to whose wages, as defined in section 1621 (a), withholding under Subchapter D of Chapter 9 is not made applicable, the total amount of tax imposed by this chapter shall be paid, in lieu of the time prescribed in section 56 (a), on the fifteenth day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the sixth month following the close of the fiscal year. [NOTE: The amendment of this provision by sec. (5) (e), Current Tax Payment Act 1943, is under sec. 5 (f) thereof, effective with respect to taxable years beginning after December 31, 1942. Such amendment added the words "with respect to * * * made applicable".]

(b) *Withholding at source.* For withholding at source of tax on income of nonresident aliens, see section 143.

§ 29.218–1 *Date on which tax shall be paid by nonresident alien individual.* In the case of a nonresident alien individual the tax is to be paid on or before the 15th day of June following the close of the calendar year, or, where the return is made on the basis of a fiscal year, on or before the 15th day of the sixth month following the close of the fiscal year. As to payment of the tax in installments, see § 29.56–1. For provisions relating to certain cases in which the date otherwise prescribed for the payment of the tax or an installment thereof is postponed by reason of the war, see Part 472 of this chapter.

SEC. 219. PARTNERSHIPS [as amended by sec. 160 (f), Rev. Act 1942].

For the purpose of this chapter, a nonresident alien individual shall be considered as being engaged in a trade or business within the United States if the partnership of which he is a member is so engaged.

§ 29.219–1 *Partnerships.* Whether a nonresident alien individual who is a member of a partnership is taxable under the provisions of (A) section 211 (a) or 211 (c) or (B) section 211 (b) may depend on the status of the partnership. A nonresident alien individual who is a member of a partnership which is not engaged in trade or business within the United States is subject to the provisions of section 211 (a) or 211 (c), as the case may be, depending on whether in the taxable year he derives fixed or determinable annual or periodical income from sources within the United States of more than $15,400, if he is not otherwise engaged in trade or business within the United States. A nonresident alien individual who is a member of a partnership which at any time within the taxable year is engaged in trade or business within the United States is considered as being engaged in trade or business within the United States and is therefore taxable under section 211 (b). For definition of what the term "partnership" includes, see section 3797 (a) (2). The test of whether a partnership is engaged in trade or business within the United States is the same as in the case of a nonresident alien individual. (See § 29.–211–7.)

FOREIGN CORPORATIONS

SEC. 231. TAX ON FOREIGN CORPORATIONS [as amended by sec. 206, Rev. Act 1939; sec. 3 (c), Rev. Act 1940; secs. 104 (d), 106, 109 (a), Rev. Act 1941; secs. 107, 160 (d) (e), Rev. Act 1942.]

(a) *Nonresident corporations*—(1) *Imposition of tax.* There shall be levied, collected,

and paid for each taxable year, in lieu of the tax imposed by sections 13 and 14, upon the amount received by every foreign corporation not engaged in trade or business within the United States, from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, a tax of 30 per centum of such amount, except that in the case of corporations organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland such rate with respect to dividends shall be reduced to such rate (not less than 5 per centum) as may be provided by treaty with such country. [NOTE: For rate of 27½ percent prior to October 31, 1942, in lieu of 30 percent, see sec. 107, Rev. Act 1942, set forth below.]

(2) *Cross reference.* For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(b) *Resident corporations.* A foreign corporation engaged in trade or business within the United States shall be taxable as provided in section 14 (c) (1) and section 15.

(c) *Gross income.* In the case of a foreign corporation gross income includes only the gross income from sources within the United States.

(d) *Ships under foreign flag.* The income of a foreign corporation, which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, shall not be included in gross income and shall be exempt from taxation under this chapter.

SEC. 107. TAX ON FOREIGN CORPORATIONS. (Revenue Act of 1942, Title I.)

Section 231 (a) (relating to tax on nonresident foreign corporations) is amended by striking out "27½ per centum" and inserting in lieu thereof "30 per centum". The amendments made by this section shall apply with respect to amounts received after the ninth day after the date of the enactment of this Act regardless of whether the taxable year of the recipient begins before January 1, 1942, or after December 31, 1941.

SEC. 109. TREATY OBLIGATIONS. (Revenue Act of 1942, Title I.)

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States.

§ 29.231–1 *Taxation of foreign corporations.* For the purposes of this section and §§ 29.231–2, 29.232–1, 29.235–1, 29.235–2 and 29.236–1, foreign corporations are divided into two classes: (1) foreign corporations not engaged in trade or business within the United States at any time within the taxable year, referred to in the regulations as nonresident foreign corporations (see § 29.3797–8); and (2) foreign corporations which at any time within the taxable year are engaged in trade or business within the United States, referred to in the regulations as resident foreign corporations (see § 29.3797–8).

(a) *Nonresident foreign corporations.* A nonresident foreign corporation is liable to the tax upon the amount received from sources within the United States, determined under the provisions of section 119, which is fixed or determinable annual or periodical gains, profits, and income. For the purposes of section 231 (a), the term "amount received" means "gross income." Specific items of fixed or determinable annual or periodical income are enumerated in the Internal Revenue Code as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, but other fixed or determinable annual or periodical gains, profits, and income are also subject to the tax, as, for instance, royalties. As to the definition of fixed or determinable annual or periodical income, see § 29.143–2. The items of fixed or determinable annual or periodical income from sources within the United States received by a corporation organized under the laws of France, which are exempt from Federal income tax under the provisions of the convention and protocol between the United States and France, signed April 27, 1932, and effective January 1, 1936 (see Part 13 of this chapter), are described in § 29.143–3. As to items of such income received on or after January 1, 1940, by Swedish corporations and exempt from Federal income taxation, see the tax convention between the United States and Sweden, effective January 1, 1940, and regulations thereunder (see Part 25 of this chapter). Under the provisions of the tax convention between the United States and Canada (ratifications exchanged June 15, 1942 (the tax rates of 27½ percent or 30 percent, as the case may be, otherwise imposed by section 231 (a) are reduced to 15 percent as to items of income in the case of such corporations organized under the laws of Canada.

The fixed or determinable annual or periodical income from sources within the United States, including royalties, of a nonresident foreign corporation is taxable at the rate of 30 percent (27½ percent as to such income received prior to October 31, 1942). In the case of dividends received by a nonresident foreign corporation organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, the rate shall be reduced to such rate (not less than 5 percent) as may be provided by treaty with such country.

(b) *Resident foreign corporations.* A resident foreign corporation is not taxable upon the items of fixed or determinable annual or periodical income enumerated in section 231 (a) at the rate specified in that section. A resident foreign corporation is, under section 14 (c) (1), liable to a tax of 24 percent of its normal-tax net income (regardless of the amount thereof), that is, its net income from sources within the United States (gross income from sources within the United States minus the statutory deductions provided in sections 23 and 232) less the credits allowed against net income by section 26 (a) and (b). A resident foreign corporation is also liable to the corporation surtax at the following rates:

(1) Upon corporation surtax net incomes of $25,000 or less, 10 percent of the amount thereof.

(2) Upon corporation surtax net incomes over $25,000 but not over $50,000, $2,500, plus 22 percent of the amount of such income in excess of $25,000.

(3) Upon corporation surtax net incomes of more than $50,000, 16 percent of the entire amount thereof.

The corporation surtax net income of a resident foreign corporation is its net income from sources within the United States less the credit allowed by section 26 (b), which credit is limited in amount to 85 percent of its net income from sources within the United States.

As used in sections 119, 143, 144, 211, and 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian. The term "commodities" as used in section 211 (b) means only goods of a kind customarily dealt in on an organized commodity exchange, such as a grain futures or a cotton futures market, and does not include merchandise in the ordinary channels of commerce.

§ 29.231–2 *Gross income of foreign corporations.* In the case of a foreign corporation, including a life insurance company not carrying on an insurance business within the United States and holding no reserve funds upon business transacted within the United States (see section 201 (b) (3)), an insurance company other than life or mutual not carrying on an insurance business within the United States (see section 204 (a) (3)), and a mutual insurance company other than life not carrying on an insurance business within the United States (see section 207 (a)), the term "gross income" means gross income from sources within the United States as defined and described in section 119. (See §§ 29.119–1 to 29.119–14, inclusive.) The items of gross income from sources without the United States and therefore not taxable to foreign corporations are described in section 119 (c). As to the definition of a foreign corporation see section 3797 (a) (3) and (5). As to foreign life insurance companies, see § 29.201 (b)–2. As to foreign corporations formed or availed of to avoid surtax, see § 29.102–4. As to personal holding companies organized under the laws of foreign countries, see § 29.505–1. As to foreign personal holding companies, see sections 331 to 340, inclusive, and §§ 29.331–1 to 29.339–3, inclusive.

(a) *Nonresident foreign corporations.* A nonresident foreign corporation is taxable under section 231 (a) only on fixed or determinable annual or periodical gross income received from sources within the United States. Its taxable income does not include profits derived from the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian, or profits derived from the sale within the United

States of personal property or real property located therein.

(b) *Resident foreign corporations.* The gross income from sources within the United States of a resident foreign corporation is not limited to the items of fixed or determinable annual or periodical income referred to in section 231 (a), but includes every item of gross income which is treated as income from sources within the United States, except those items which are specifically exempt from taxation by statute or treaty or which are not taxable by the Federal Government under the Constitution. (See section 22 (b), 119, and 231 (d).)

A foreign corporation which effects transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian is not merely by reason of such transactions considered as being engaged in trade or business within the United States which would cause it to be classed as a resident foreign corporation. However, a foreign corporation which at any time within the taxable year is otherwise engaged in trade or business in the United States, being a resident foreign corporation, is taxable upon all income derived from sources within the United States, including the profits realized from such transactions. A resident foreign corporation is also required to include in its gross income capital gains, gains from hedging transactions, and profits derived from the sale within the United States of personal property, or of real property located therein.

§ 29.231–3 *Exclusion of earnings of foreign ships from gross income.* A resident foreign corporation may exclude from gross income under section 231 (d) so much of its income from sources within the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country, to the same extent as provided in § 29.212–2 with respect to nonresident alien individuals.

A nonresident foreign corporation is not required to include in gross income such income from sources within the United States as is derived from the operation of a ship or ships, whether or not the foreign country under the laws of which such ships are documented meets the equivalent exemption requirements of the statute.

SEC. 232. DEDUCTIONS.

(a) *In general.* In the case of a foreign corporation the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119, under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(b) *Charitable, and so forth, contributions.* The so-called "charitable contribution" deduction allowed by section 23 (q) shall be allowed whether or not connected with income from sources within the United States.

§ 29.232–1 *Deductions allowed foreign corporations*—(a) *Nonresident foreign corporations.* A nonresident foreign corporation is not allowed any deductions from gross income from sources within the United States, the tax being imposed upon the amount of gross income received. (See § 29.231–1.)

(b) *Resident foreign corporations.* A resident foreign corporation is allowed the same deductions from its gross income arising from sources within the United States as are allowed a domestic corporation under section 23 to the extent that such deductions are connected with such gross income, except that the so-called charitable contribution deduction allowed by section 23 (q) is allowed whether or not connected with income from sources within the United States. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119. As to foreign life insurance companies, see § 29.201 (b)–2. As to foreign corporations formed or availed of to avoid surtax, see § 29.102–4. As to personal holding companies organized under the laws of foreign countries, see § 29.505–1. As to foreign personal holding companies, see sections 331 to 340, inclusive, and §§ 29.331–1 to 29.339–3, inclusive.

SEC. 233. ALLOWANCE OF DEDUCTIONS AND CREDITS.

A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this chapter only by filing or causing to be filed with the collector a true and accurate return of its total income received from all sources in the United States, in the manner prescribed in this chapter; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

§ 29.233–1 *Allowance of deductions and credits.* The benefit of the deductions and credits allowed a resident foreign corporation can be had only by filing or causing to be filed with the collector a true and accurate return of its total income received from sources within the United States. Only items of interest and dividends included in gross income may be credited under section 26 (a) and (b). Inasmuch as a nonresident foreign corporation is taxable under section 231 (a) only upon fixed or determinable annual or periodical gross income received from sources within the United States, such foreign corporation may not receive the benefit of the deductions and credits by filing a return of income.

SEC. 234. CREDITS AGAINST TAX [as amended by sec. 505, 2d Rev. Act 1940].

Foreign corporations shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131. A foreign corporation shall be allowed as a credit against its tax the amount required by section 396 to be paid by the personal service corporation of which it is a shareholder with respect to its tax liability under Supplement S.

SEC. 235. RETURNS.

(a) *Time of filing.* In the case of a foreign corporation not having any office or place of business in the United States the return, in lieu of the time prescribed in section 53 (a) (1), shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year then on or before the fifteenth day of June. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent.

(b) *Exemption from requirement.* Subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Commissioner, with the approval of the Secretary, corporations subject to the tax imposed by section 231 (a) may be exempted from the requirement of filing returns of such tax.

§ 29.235–1 *Time and place for filing returns of foreign corporations*—(a) *Nonresident foreign corporations.* The return in the case of a nonresident foreign corporation must be made on or before the 15th day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of a calendar then on or before the 15th day of June. If a nonresident foreign corporation has an agent in the United States, the return shall be made by the agent. The return must be filed with the collector of internal revenue, Baltimore, Md. (See section 53 (b) (2).) For failure to make and file a return within the time prescribed, see section 291. For cases in which no return is required, see § 29.235–2 (*a*). For provisions relating to certain cases in which the time for filing the return is postponed by reason of the war, see Part 472 of this chapter.

(b) *Resident foreign corporations.* The return in the case of a resident foreign corporation, in lieu of the time prescribed in section 235, shall be made on or before the 15th day of the third month following the close of the fiscal year, or on or before the 15th day of March if on the basis of the calendar year. (See section 53 (a) (1).) If the return is for a fractional part of a year, it shall be filed at the time prescribed in § 29.53–1. The return must be filed with the collector of internal revenue for the district in which the resident foreign corporation has its principal place of business or principal office or agency in the United States. (See section 53 (b) (2).) For failure to make and file a return within the time prescribed, see section 291. For provisions relating to certain cases in which the time for filing the return is postponed by reason of the war, see Part 472 of this chapter.

§ 29.235–2 *Return of income*—(a) *Nonresident foreign corporations.* If the tax liability of a nonresident foreign corporation is fully satisfied at the source a return of income is not required. A nonresident foreign corporation shall make or have made a return on Form 1120NB with respect to that portion of its income received from sources within the United States consisting of interest on so-called tax-free covenant bonds on which a tax of only 2 percent was withheld at the source, and with respect to any other fixed or determinable annual or periodical income upon which the tax was not fully satisfied at the source, including dividends received from a foreign corporation which are treated as income from sources within the United States under section 119 (a) (2) (B), and shall pay the balance of the tax shown to be due.

(b) *Resident foreign corporations.* If a foreign corporation at any time within the taxable year is a resident corporation it shall make a full and accurate return on Form 1120 of its income received from sources within the United States.

SEC. 236. PAYMENT OF TAX.

(a) *Time of payment.* In the case of a foreign corporation not having any office or place of business in the United States the total amount of tax imposed by this chapter shall be paid, in lieu of the time prescribed in section 56 (a), on the fifteenth day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the sixth month following the close of the fiscal year.

(b) *Withholding at source.* For withholding at source of tax on income of foreign corporations, see section 144.

§ 29.236–1 *Dates on which tax shall be paid by foreign corporations*—(a) *Nonresident foreign corporations.* In the case of a nonresident foreign corporation the total amount of tax imposed by chapter 1 shall be paid on the 15th day of June following the close of the calendar year, or if the return should be made on the basis of a fiscal year, then on the 15th day of the sixth month following the close of the fiscal year. As to payment of the tax in installments, see § 29.56–1. For provisions relating to certain cases in which the date otherwise prescribed for the payment of the tax or an installment thereof is postponed by reason of the war, see Part 472 of this chapter.

(b) *Resident foreign corporations.* In the case of a resident foreign corporation the total amount of tax imposed by chapter 1 shall be paid, in lieu of the time prescribed in section 236 (a), on the 15th day of March following the close of the calendar year, or if the return is made on the basis of a fiscal year, then on the 15th day of the third month following the close of the fiscal year. If the return is made for a fractional part of a year, the tax shall be paid at the time prescribed in § 29.56–1 (a). As to payment of the tax in installments, see § 29.56–1. For provisions relating to certain cases in which the date otherwise prescribed for the payment of the tax or an installment thereof is postponed by reason of the war, see Part 472 of this chapter.

SEC. 237. FOREIGN INSURANCE COMPANIES.

For special provisions relating to foreign insurance companies, see Supplement G.

POSSESSIONS OF THE UNITED STATES

SEC. 251. INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES [as amended by sec. 207, Rev. Act 1939; sec. 6 (c), Rev. Act 1940; secs. 104 (e), 111 (c), Rev. Act 1941; secs. 131 (a), 159 (d), 160 (d), Rev. Act 1942].

(a) *General rule.* In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section), for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

(2) If, in the case of such corporation, 50 per centum or more of its gross income computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(3) If, in case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) *Amounts received in United States.* Notwithstanding the provisions of subsection (a) there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) *Tax in case of corporation*—(1) *Corporation tax.* A domestic corporation entitled to the benefits of this section shall be subject to tax under section 13 or section 14 (b), and under section 15.

(2) *Cross reference.* For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(d) *Definition.* As used in this section the term "possession of the United States" does not include the Virgin Islands of the United States.

(e) *Deductions.* (1) Citizens of the United States entitled to the benefits of this section shall have the same deductions as are allowed by Supplement H in the case of a nonresident alien individual engaged in trade or business within the United States.

(2) Domestic corporations entitled to the benefits of this section shall have the same deductions as are allowed by Supplement I in the case of a foreign corporation engaged in trade or business within the United States.

(f) *Credits against net income.* A citizen of the United States entitled to the benefits of this section shall be allowed a personal exemption of only $500 and shall not be allowed the credit for dependents provided in section 25 (b) (2).

(g) *Allowance of deductions and credits.* Citizens of the United States and domestic corporations entitled to the benefits of this section shall receive the benefit of the deductions and credits allowed to them in this chapter only by filing or causing to be filed with the collector a true and accurate return of their total income received from all sources in the United States, in the manner prescribed in this chapter; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(h) *Credits against tax.* Persons entitled to the benefits of this section shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

§ 29.251–1 *Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States.* In the case of a citizen of the United States or a domestic corporation satisfying the following conditions, gross income means only gross income from sources within the United States:

(a) If 80 percent or more of the gross income of such citizen or domestic corporation (computed without the benefit of section 251) for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States, and

(b) If 50 percent or more of the gross income of such citizen or domestic corporation (computed without the benefit of section 251) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States. In the case of a citizen, the trade or business may be conducted on his own account or as an employee or agent of another. The salary or other compensation paid by the United States to the members of its civil, military, or naval personnel for services rendered within a possession of the United States represents income derived from the active conduct of a trade or business within a possession of the United States. Dividends received by a citizen from a corporation whose income was derived from the active conduct of a business within a possession of the United States, although such citizen was actively engaged in the management of such corporation, does not represent income derived from the active conduct of a trade or business within the possession of the United States, either on the taxpayer's own account or as an employee or agent of another.

A citizen of the United States who on account of the nature and amount of his income cannot meet the 80 percent and the 50 percent requirements of the Internal Revenue Code, but who receives earned income from sources within a possession of the United States, is not deprived of the benefits of the provisions of section 116 (a), provided that (1) he is, with respect to taxable years beginning prior to January 1, 1943, away from the United States for more than six months of the taxable year, or is, with respect to taxable years beginning after December 31, 1942, a bona fide resident of a foreign country or countries during the entire taxable year, and (2) he does not receive his earned income from the United States or any agency thereof. In such a case none of the provisions of section 251 is applicable in determining the citizen's tax liability. For what constitutes earned income, see section 25 (a) (4).

In the case of a husband and wife making a joint return, the term "gross income," as used in this section, means the combined gross income of the spouses.

For a determination of the income from sources within the United States, see section 119. A citizen entitled to the benefits of section 251 is required to file with his individual return Form 1040 or 1040A, the schedule on Form 1040E. If a citizen entitled to the benefits of section 251 has no income from sources within the United States or does not receive within the United States any income whether derived from sources within or without the United States, he is not required to file a return or the schedule on Form 1040E.

Example. On July 1, 1942, A, who is a citizen of the United States, went to Puerto Rico and established a business there which he actively conducted during the remainder of that year. His gross income from the business during such period was $20,000. In addition, he made a profit of $12,000 from the sale during the latter part of 1942 of some

Puerto Rican real estate not connected with his trade or business. In the first six months of 1942 he also derived $8,000 gross income from rental property located in the United States. He derived a like amount of gross income from such property during the last six months of 1942. Inasmuch as for the applicable part (July 1, 1942, to December 31, 1942) of the 3-year period immediately preceding the close of the taxable year (the calendar year 1942), 80 percent of A's gross income ($32,000, or 80 percent of $40,000) was derived from sources within a possession of the United States and as 50 percent or more of his gross income ($20,000, or 50 percent of $40,000) for such part of the 3-year period was derived from the active conduct of a trade or business within a possession of the United States, he is required to report in gross income in his return for 1942 only the gross income derived by him from sources within the United States ($16,000 from the rental property located in the United States.)

§ 29.251–2 *Income received within the United States.* Notwithstanding the provisions of section 251 (a), there shall be included in the gross income of citizens and domestic corporations therein specified all amounts, whether derived from sources within or without the United States, which are received by such citizens or corporations within the United States. From the amounts so included in gross income there shall be deducted only the expenses properly apportioned or allocated thereto. For instance, if in the example given in § 29.251–1, the taxpayer during the latter part of 1942 returned to the United States for a few weeks and while there received the proceeds resulting from the sale of the Puerto Rican real estate, the profits derived from such transaction should be reported in gross income. Such receipt in the United States, however, would not deprive the taxpayer of the benefits of section 251 with respect to other items of gross income excluded by that section.

§ 29.251–3 *Tax in case of corporations.* A domestic corporation entitled to the benefits of section 251 is, under section 251 (c) (1), subject to the tax imposed by section 13 if it has a normal-tax net income of more than $25,000 (see § 29.13–1), or to the tax provided by section 14 (b) if it has a normal-tax net income of not more than $25,000 (see § 29.14–1). Such a corporation is also subject to the surtax imposed by section 15 (see § 29.15–1).

§ 29.251–4 *Definition.* The term "United States" as used herein includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia. The term "possession of the United States," as used in sections 251 and 252 and § 29.251–1, this section, and § 29.252–1, includes Puerto Rico, the Philippine Islands, the Panama Canal Zone, Guam, American Samoa, Wake, and the Midway Islands; it does not include the Virgin Islands. The Philippine Islands come within the classification of "possessions of the United States" for Federal income tax purposes, notwithstanding the establishment of the Commonwealth of the Philippines under the Act of March 24, 1934 (48 Stat. 456).

§ 29.251–5 *Deductions allowed citizens and domestic corporations entitled to the benefits of section 251.* In the case of a citizen entitled to the benefits of section 251, the deductions allowed by section 23 for business expenses, interest, taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the United States. The provisions of § 29.213–1 relating to the allowance to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States, of the deductions provided in section 23 (e) (2) and (3) for losses not connected with the trade or business are applicable in the case of citizens entitled to the benefits of section 251. The provisions of § 29.213–1 pertaining to the allowance to such nonresident alien individuals of deductions for contributions provided in section 23 (o) are also applicable in the case of such citizens. Corporations entitled to the benefits of section 251 are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations to the extent that such deductions are connected with such gross income, except that the so-called charitable contribution deduction allowed by section 23 (q) is allowed whether or not connected with income from sources within the United States. The proper appportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119.

§ 29.251–6 *Allowance of deductions and credits to citizens and domestic corporations entitled to the benefits of section 251.* Unless a citizen of the United States or a domestic corporation entitled to the benefits of section 251 shall file or cause to be filed with the collector a true and accurate return of total income from sources within the United States, the tax shall be collected on the basis of the gross income (not the net income) from sources within the United States. Where such a citizen or corporation has various sources of income within the United States so that the total income calls for the assessment of a tax, and a return of income was not filed by or on behalf of the citizen or corporation, the Commissioner will cause a return of income to be made and include therein the income of such citizen or corporation from all sources concerning which he has information, and will assess the tax and collect it from one or more of the sources of income of such citizen or corporation within the United States without allowance for deductions or credits.

SEC. 252. CITIZENS OF POSSESSIONS OF UNITED STATES.

(a) Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this chapter only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

(b) Nothing in this section shall be construed to alter or amend the provisions of the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes", approved July 12, 1921, c. 44, 42 Stat. 123 (U.S.C., Title 48, § 1397), relating to the imposition of income taxes in the Virgin Islands of the United States.

§ 29.252–1 *Status of citizens of United States possession.* A citizen of a possession of the United States (except the Virgin Islands), who is not otherwise a citizen or resident of the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual. (See sections 211 to 219, inclusive.) For Federal income tax purposes a citizen of a possession of the United States who is not otherwise a citizen of the United States is a citizen of a possession of the United States who has not become a citizen of the United States by naturalization. The fixed or determinable annual or periodical income from sources within the United States of a citizen of a possession of the United States who is treated as if he were a nonresident alien individual is subject to withholding. (See section 143.)

For the purpose of this section citizens of the possessions of the United States who are not otherwise citizens of the United States are divided into two classes: (1) citizens of possessions of the United States who at any time within the taxable year are not engaged in trade or business within the United States and (2) citizens of possessions of the United States who at any time within the taxable year are engaged in trade or business within the United States. The provisions of §§ 29.211–7 to 29.219–1, inclusive, applicable to nonresident alien individuals not engaged in trade or business within the United States, are applicable to the citizens of possessions falling within the first class, while the provisions of such sections applicable to nonresident alien individuals who at any time within the taxable year are engaged in trade or business within the United States are applicable to citizens of possessions falling within the second class.

The Act referred to in section 252 (b) provides that income tax laws then or thereafter in force in the United States shall apply to the Virgin Islands, but that the taxes shall be paid into the treasury of the Virgin Islands. Accordingly, persons are taxed there under the income tax provisions of the Internal Revenue Code.

CHINA TRADE ACT CORPORATIONS

SEC. 261. TAXATION IN GENERAL [as amended by sec. 208, Rev. Act 1939; sec. 104 (f) (1), Rev. Act 1941].

(a) *Corporation tax.* A corporation organized under the China Trade Act, 1922 (42 Stat. 849; U. S. C., 1934 ed., title 15, ch. 4), shall be subject to tax under section 13 or section 14 (b), and under section 15.

(b) *Cross reference.* For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

§ 29.261–1 *Tax on China Trade Act corporations.* A China Trade Act cor-

poration is, under section 261 (a), subject to the tax imposed by section 13 (b) if it has a normal-tax net income of more than $25,000 (see § 29.13–1), or to the tax provided by section 14 (b) if it has a normal-tax net income of not more than $25,000 (see § 29.14–1). Such a corporation is also subject to the surtax imposed by section 15 (see § 29.15–1).

SEC. 262. CREDIT AGAINST NET INCOME [as amended by sec. 210 (c), Rev. Act 1939; sec. 204 (f) (2), Rev. Act. 1941.]

(a) *Allowance of credit.* For the purpose only of the taxes imposed by sections 13, 14, 15, and 600 of this title and section 106 of the Revenue Act of 1935 there shall be allowed, in the case of a corporation organized under the China Trade Act, 1922, in addition to the credits against net income otherwise allowed such corporation, a credit against the net income of an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date: *Provided*, That in no case shall the diminution, by reason of such credit, of the tax imposed by such section 13, 14, or 15 (computed without regard to this section) exceed the amount of the special dividend certified under subsection (b) of this section; and in no case shall the diminution, by reason of such credit, of the tax imposed by such section 106 or 600 (computed without regard to this section) exceed the amount by which such special dividend exceeds the diminution permitted by this section in the tax imposed by such section 13, 14, or 15.

(b) *Special dividend.* Such credit shall not be allowed unless the Secretary of Commerce has certified to the Commissioner—

(1) The amount which, during the year ending on the date fixed by law for filing the return, the corporation has distributed as a special dividend to or for the benefit of such persons as on the last day of the taxable year were resident in China, the United States, or possessions of the United States, or were individual citizens of the United States or China, and owned shares of stock of the corporation;

(2) That such special dividend was in addition to all other amounts, payable or to be payable to such persons or for their benefit, by reason of their interest in the corporation; and

(3) That such distribution has been made to or for the benefit of such persons in proportion to the par value of the shares of stock of the corporation owned by each; except that if the corporation has more than one class of stock, the certificates shall contain a statement that the articles of incorporation provide a method for the apportionment of such special dividend among such persons, and that the amount certified has been distributed in accordance with the method so provided.

(c) *Ownership of stock.* For the purposes of this section shares of stock of a corporation shall be considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

(d) *Definition of China.* As used in this section the term "China" shall have the same meaning as when used in the China Trade Act, 1922.

§ 29.262–1 *Income of China Trade Act corporations.* The items of gross income to be included in the return of a corporation organized under the China Trade Act and the deductions allowable are the same as in the case of other domestic corporations.

§ 29.262–2 *Credits allowed China Trade Act corporations.* In addition to the credits allowed under section 26 (a) and (b), a China Trade Act corporation is, under certain conditions, allowed an additional credit for the purpose of computing the taxes imposed by section 13 or 14, by section 15, and by section 600. This credit is an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation, owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date. The decrease in the tax imposed by section 13 or 14, and section 15, by reason of such credit must not, however, exceed the amount of the special dividend referred to in section 262 (b), and is not allowable unless the special dividend has been certified to the Commissioner by the Secretary of Commerce. The decrease in the tax imposed by section 600 by reason of such credit must not exceed the amount by which such special dividend exceeds the decrease permitted by section 262 in the tax imposed by section 13 or 14, and section 15. A China Trade Act corporation is not entitled to the credit for taxes paid to foreign countries and possessions of the United States allowed to domestic corporations under the provisions of section 131.

The application of this section may be illustrated by the following example:

Example. The A Company, a China Trade Act corporation, has a net income for the calendar year 1942 of $200,000 and receives no dividends from domestic corporations. All of its stock on December 31, 1942, is owned on that date by persons resident in China, he United States, or possessions of the United States, or individual citizens of the United States or China. The declared value of the capital stock of the corporation shown on its capital stock tax return for the capital stock tax year ended June 30, 1942, is $1,500,000. It distributes a special dividend amounting to $85,000 on February 15, 1943, which is certified by the Secretary of Commerce as provided in section 262 (b).

For the purpose of the tax imposed by section 13, it is necessary in this example to make two computations, first, without allowing the special credit against net income on account of income derived from sources within China, and, second, allowing such credit. The computations are as follows:

FIRST COMPUTATION—WITHOUT ALLOWING THE SPECIAL CREDIT AGAINST NET INCOME

Net income subject to tax	$200,000
Normal-tax net income	200,000
Normal tax (section 13)	48,000
Surtax net income	200,000
Surtax (section 15)	32,000
Total income tax	80,000

SECOND COMPUTATION—ALLOWING SPECIAL CREDIT AGAINST NET INCOME

Net income	$200,000
Since the total net income is derived from sources within China and since the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, is 100 percent of the par value of the total number of shares of stock of the corporation outstanding on that day, 100 percent of the net income from sources within China is deductible as a special credit against net income.	
Special credit against net income	200,000
Amount of income subject to tax under section 13	None

Since the special dividend ($85,000) exceeds the diminution of the tax ($80,000) on account of the allowance of the special credit against net income, the entire amount of the special credit is allowable and the corporation has no income tax liability for 1942.

For the purpose of the declared value excess-profits tax it is also necessary to make two computations, first, without allowing the special credit against net income, and, second, allowing such credit. The computations are as follows:

FIRST COMPUTATION—WITHOUT ALLOWING THE SPECIAL CREDIT AGAINST NET INCOME

Net income	$200,000
Less: 10 percent of the value declared in the capital stock tax return for the capital stock tax year ended June 30, 1942 (10 percent of $1,500,000)	150,000
Net income subject to declared value excess-profits tax	50,000
Less: Amount taxable at 6⁹⁄₁₀ percent, portion of net income in excess of 10 percent and not in excess of 15 percent of the declared value of the capital stock ($200,000 minus $150,000)	50,000
Amount taxable at 13⅔ percent	None
Declared value excess-profits tax at 6⁹⁄₁₀ percent (6⁹⁄₁₀ percent of $50,000)	3,300

SECOND COMPUTATION—ALLOWING SPECIAL CREDIT AGAINST NET INCOME

Net income	$200,000
Since the total net income is derived from sources within China and since the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, th United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, is 100 percent of the par value of the total number of shares of stock of the corporation outstanding on that day, 100 percent of the net income from sources within China is deductible from net income	200,000
Amount of income subject to declared value excess-profits tax	None

Since the diminution of the declared value excess-profits tax ($3,300) on account of the special credit against net income does not exceed the amount by which the special dividend ($85,000) exceeds the diminution of the income tax ($80,000) on account of such credit, the entire amount of the special credit ($200,000) is allowable and the corporation has no declared value excess-profits tax liability for 1942.

§ 29.262–3 *Meaning of terms used in connection with China Trade Act corporations.* A China Trade Act corporation is one organized under the provisions of the China Trade Act, 1922.

The term "China" means (1) China, including Manchuria, Tibet, Mongolia, and any territory leased by China to any foreign government, (2) the Crown Colony of Hong Kong, and (3) the Province of Macao.

The term "special dividend" means the amount which during the year ending on March 15 succeeding the close of the corporation's taxable year is distributed as a special dividend to or for the benefit of such persons as on the last day of the taxable year were resident in China, the United States, or possessions of the United States, or were individual citizens of the United States or China, and owned shares of stock of the corporation. Such special dividend does not include any other amounts payable or to be payable to such persons or for their benefit by reason of their interest in the corporation and must be made in proportion to the par value of the shares of stock of the corporation owned by each.

For the purposes of section 262 the shares of stock of a China Trade Act corporation are considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

"Net income derived from sources within China" is the sum of the net income from sources wholly within China and that portion of the net income from sources partly within and partly without China which may be allocated to sources within China. The method of computing this income is similar to that described in section 119.

§ 29.262–4 *Withholding by a China Trade Act corporation.* Dividends distributed by a corporation organized under the China Trade Act, 1922, which are treated as income from sources within the United States under the provisions of section 119 of the Internal Revenue Code are subject to withholding at the rate of 30 percent (27½ percent prior to October 31, 1942) when paid to persons (other than residents of China) who are (a) nonresident aliens, (b) nonresident partnerships composed in whole or in part of nonresident aliens, or (c) nonresident foreign corporations. The 30 percent (27½ percent prior to October 31, 1942) rate of withholding specified in this section with respect to dividends shall be reduced in the case of shareholders who are (1) nonresident aliens residents of any country in North, Central, or South America, or in the West Indies, or of Newfoundland, or (2) nonresident foreign corporations organized under the laws of any such country, to such rate (not less than 5 percent) as may be provided by treaty with such country. As to reduction in rate of withholding (i) in the case of nonresident alien individuals who are residents of Canada or Sweden, see § 29.143–1; (ii) in the case of corporations or other entities created or organized under the laws of Canada or Sweden, see § 29.144–1.

SEC. 263. CREDITS AGAINST THE TAX.

A corporation organized under the China Trade Act, 1922, shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

SEC. 264. [Not applicable to taxable years beginning after December 31, 1941.]

SEC. 265. INCOME OF SHAREHOLDERS.

For exclusion of dividends from gross income, see section 116.

ASSESSMENT AND COLLECTION OF DEFICIENCIES

SEC. 271. DEFINITION OF DEFICIENCY.

As used in this chapter in respect of a tax imposed by this chapter "deficiency" means—

(a) The amount by which the tax imposed by this chapter exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or

(b) If no amount is shown as the tax by the taxpayer upon his return, or if no return is made by the taxpayer, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a deficiency; but such amounts previously assessed, or collected without assessment, shall first be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect to such tax.

§ 29.271–1 *Deficiency defined.* Section 271 by its definition of the word "deficiency" provides a term which will apply to any amount of tax determined to be due in respect of a taxable year in excess of the amount of tax reported by the taxpayer for such year; or in excess of the amount reported by the taxpayer as adjusted by way of prior assessments, abatements, credits, refunds, or collections without assessment. In defining the term "deficiency" section 271 recognizes two classes of cases—one, where the taxpayer makes a return showing some tax liability; the other, where the taxpayer makes a return showing no tax liability, or where the taxpayer fails to make a return. Additional tax shown on an "amended return," so called, is a deficiency within the meaning of the Internal Revenue Code.

When a case is considered for the first time, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount shown as the tax by the taxpayer on his return, or, if it is a case where no tax was reported by the taxpayer, the deficiency is the amount determined to be the correct amount of the tax. Subsequent information sometimes discloses that the amount previously determined to be the correct amount of the tax is less than the correct amount, and that a redetermination of the tax is necessary. In such a case the deficiency on redetermination is the excess of the amount determined to be the correct amount of the tax over the sum of the amount of tax reported by the taxpayer and the deficiency assessed in connection with the previous determination. If it is a case where no tax was reported by the taxpayer, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount of the deficiency disclosed by the previous determination. If the previous determination resulted in a credit or refund to the taxpayer, the deficiency upon the second determination is the excess of the amount determined to be the correct amount of the tax over the amount of tax reported by the taxpayer decreased by the amount of the credit or refund.

SEC. 272. PROCEDURE IN GENERAL [as amended by sec. 168 (a), Rev. Act. 1942].

(a) (1) *Petition to Board of Tax Appeals.* If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals [known as The Tax Court of the United States] for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of section 3653 (a) the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court. In the case of a joint return filed by husband and wife such notice of deficiency may be a single joint notice, except that if the Commissioner has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, duplicate originals of the joint notice must be sent by registered mail to each spouse at his last known address. If the notice is addressed to a person outside the States of the Union and the District of Columbia, the period specified in this paragraph shall be one hundred and fifty days in lieu of ninety days.

(2) *Cross references.* For exceptions to the restrictions imposed by this subsection, see—

Subsection (d) of this section, relating to waivers by the taxpayer;

Subsection (f) of this section, relating to notifications of mathematical errors appearing upon the face of the return;

Section 273, relating to jeopardy assessments;

Section 274, relating to bankruptcy and receiverships; and

Section 1145, relating to assessment or collection of the amount of the deficiency determined by the Board pending court review.

(b) *Collection of deficiency found by Board.* If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

(c) *Failure to file petition.* If the taxpayer does not file a petition with the Board within

the time prescribed in subsection (a) of this section, the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the collector.

(d) *Waiver of restrictions.* The taxpayer shall at any time have the right, by a signed notice in writing filed with the Commissioner, to waive the restrictions provided in subsection (a) of this section on the assessment and collection of the whole or any part of the deficiency.

(e) *Increase of deficiency after notice mailed.* The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

(f) *Further deficiency letters restricted.* If the Commisisoner has mailed to the taxpayer notice of a deficiency as provided in subsection (a) of this section, and the taxpayer files a petition with the Board within the time prescribed in such subsection, the Commissioner shall have no right to determine any additional deficiency in respect of the same taxable year, except in the case of fraud, and except as provided in subsection (e) of this section, relating to assertion of greater deficiencies before the Board, or in section 273 (c), relating to the making of jeopardy assessments. If the taxpayer is notified that, on account of a mathematical error appearing upon the face of the return, an amount of tax in excess of that shown upon the return is due, and that an assessment of the tax has been or will be made on the basis of what would have been the correct amount of tax but for the mathematical error, such notice shall not be considered (for the purposes of this subsection, or of subsection (a) of this section, prohibiting assessment and collection until notice of deficiency has been mailed, or of section 322 (c), prohibiting credits or refunds after petition to the Board of Tax Appeals) as a notice of a deficiency, and the taxpayer shall have no right to file a petition with the Board based on such notice, nor shall such assessment or collection be prohibited by the provisions of subsection (a) of this section.

(g) *Jurisdiction over other taxable years.* The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

(h) *Final decisions of Board.* For the purposes of this chapter the date on which a decision of the Board becomes final shall be determined according to the provisions of section 1140.

(i) *Prorating of deficiency to installments.* If the taxpayer has elected to pay the tax in installments and a deficiency has been assessed, the deficiency shall be prorated to the four installments. Except as provided in section 273 (relating to jeopardy assessments), that part of the deficiency so prorated to any installment the date for payment of which has not arrived, shall be collected at the same time as and as part of such installment. That part of the deficiency so prorated to any installment the date for payment of which has arrived, shall be paid upon notice and demand from the collector.

(j) *Extension of time for payment of deficiencies.* Where it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date prescribed for the payment thereof will result in undue hardship to the taxpayer the Commissioner, under regulations prescribed by the Commissioner, with the approval of the Secretary, may grant an extension for the payment of such deficiency for a period not in excess of eighteen months, and, in exceptional cases, for a further period not in excess of twelve months. If an extension is granted, the Commissioner may require the taxpayer to furnish a bond in such amount, not exceeding double the amount of the deficiency, and with such sureties, as the Commissioner deems necessary, conditioned upon the payment of the deficiency in accordance with the terms of the extension. No extension shall be granted if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(k) *Address for notice of deficiency.* In the absence of notice to the Commissioner under section 312 (a) of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by this chapter, if mailed to the taxpayer at his last known address, shall be sufficient for the purposes of this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

§ 29.272–1 *Assessment of a deficiency.* If the Commissioner determines that there is a deficiency in respect of the income tax imposed by chapter 1 (see sections 57 and 271), the Commissioner is authorized to notify the taxpayer of the deficiency by registered mail. If a joint return has been filed by husband and wife the Commissioner may, unless he has been notified by either spouse that a separate residence has been established, send either a joint or separate notice of deficiency. If, however, the Commissioner has been so notified, a separate notice of deficiency, that is, a duplicate original of the joint notice, must be sent by registered mail to each spouse at his or her last known address. The notice to the Commissioner provided for in section 272 (a), relating to separate residences, should be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the attention of the Income Tax Unit, Records Division. Within 90 days after notice of the deficiency is mailed (or within 150 days after mailing in the case of such a notice mailed after October 21, 1942, and addressed to a person outside the States of the Union and the District of Columbia), as provided in section 272 (a), a petition may be filed with The Tax Court of the United States for a redetermination of the deficiency. In determining such 90-day or 150-day period, Sunday or a legal holiday in the District of Columbia is not to be counted as the ninetieth or one hundred fiftieth day. Except as stated in paragraphs (a), (b), (c), (d), and (e) of this section, no assessment of a deficiency in respect of a tax imposed by chapter 1 shall be made until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, nor, if a petition has been filed with The Tax Court, until the decision of The Tax Court has become final. As to the date on which a decision of The Tax Court becomes final, see section 1140.

(a) If a taxpayer is notified of an additional amount of tax due on account of a mathematical error appearing upon the face of the return, such notice is not to be considered as a notice of deficiency, and the taxpayer has no right to file a petition with The Tax Court upon the basis of such notice, nor is the assessment of such additional tax prohibited by the provisions of section 272 (a).

(b) If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, such deficiency shall be assessed immediately, as provided in section 273. (See § 29.273–1.)

(c) Upon the adjudication of bankruptcy of any taxpayer or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency determined by the Commissioner in respect of the tax shall be assessed immediately, irrespective of the provisions of section 272 (a), if such deficiency has not been assessed in accordance with law prior to the adjudication of bankruptcy or the appointment of a receiver. (See sections 274 and 298 and §§ 29.274–1 and 29.274–2.)

(d) (1) If The Tax Court renders a decision and determines that there is a deficiency, and, if the taxpayer duly files a petition for review of the decision by a circuit court of appeals (or the United States Court of Appeals for the District of Columbia), the filing of the petition will not operate as a stay of the assessment of any portion of the deficiency determined by The Tax Court unless he has filed a bond with The Tax Court as provided in section 1145. If in such a case the necessary bond has not been filed by the taxpayer on or before the time his petition for review is filed, the amount determined by The Tax Court as the deficiency will be assessed immediately after the filing of such petition.

(2) If the Commissioner files a petition for review and (i) if the taxpayer has not filed a petition for review within three months after the decision of The Tax Court is rendered, or (ii) if such petition has been filed by the taxpayer, but the necessary bond referred to in section 1145 has not been filed with The Tax Court on or before the time his petition for review is filed, the amount determined by The Tax Court as the deficiency will be assessed in the case of (i), immediately after the expiration of the 3-month period, and in the case of (ii), immediately after the filing of the petition for review by the taxpayer.

(e) The taxpayer may at any time by a signed notice in writing filed with the Commissioner waive the restrictions on the assessment of the whole or any part of the deficiency. The notice must in all cases be filed with the Commissioner. The filing of such notice with The Tax Court does not constitute filing with the Commissioner within the meaning of the Internal Revenue Code. After such waiver has been acted upon by the Commissioner and the assessment has been made in accordance with its terms, the waiver cannot be withdrawn.

If a petition is filed with The Tax Court, the taxpayer should notify the Commissioner that the petition has been filed, in order to prevent an assessment by the Commissioner of the amount determined to be the deficiency. If no petition is filed with The Tax Court

within the period prescribed, the Commissioner shall assess the amount determined by him as the deficiency and of which he has notified the taxpayer by registered mail. In such case the Commissioner will not be precluded from determining a further deficiency and notifying the taxpayer thereof by registered mail. Where a petition is filed with The Tax Court, the entire amount redetermined as the deficiency by the decision of The Tax Court which has become final shall be assessed by the Commissioner. If the Commissioner mails to the taxpayer notice of a deficiency, and the taxpayer files a petition with The Tax Court within the prescribed period, the Commissioner is barred from determining any additional deficiency for the same taxable year except in the case of fraud and except as provided in section 272 (e) relating to the assertion of greater deficiencies before The Tax Court or in section 273 relating to jeopardy assessments.

§ 29.272–2 *Collection of a deficiency.* Where a deficiency as redetermined by a decision of The Tax Court which has become final is assessed, or where the taxpayer has not filed a petition and the deficiency as determined by the Commissioner has been assessed, the amount so assessed shall be paid upon notice and demand from the collector. As to cases coming within the provisions of paragraphs (b), (c), and (d) of § 29.272–1, see sections 273 (i) and 298 and section 1145. As to interest on deficiencies, see section 292.

§ 29.272–3 *Extension of time for payment of a deficiency.* If it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date or dates prescribed for the payment thereof will result in undue hardship to the taxpayer, the Commissioner may grant an extension of time for the payment of the deficiency or any part thereof for a period not in excess of 18 months, and in exceptional cases for a further period not in excess of 12 months. The extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the taxpayer from making payment of the deficiency at the due date. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship. The Internal Revenue Code provides that no extension will be granted where the deficiency is due to negligence or intentional disregard of rules and regulations or to fraud with intent to evade tax.

An application for an extension of time for the payment of a deficiency should be made under oath on Form 1127 and must be accompanied or supported by evidence showing the undue hardship that would result to the taxpayer if the extension were refused. A sworn statement of assets and liabilities of the taxpayer and an itemized statement under oath showing all receipts and disbursements for each of the three months immediately preceding the month in which falls the date prescribed for the payment of the deficiency are required and should accompany the application. The application, with the evidence, must be filed with the collector, who will transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner, it will be examined and, if possible, within 30 days will be denied, granted, or tentatively granted subject to certain conditions of which the taxpayer will be notified. The Commissioner will not consider an application for an extension of time for the payment of a deficiency unless request therefor is made to the collector on or before the date prescribed for payment thereof, as shown by the notice and demand from the collector, or on or before the date or dates prescribed for payment in any prior extension granted.

As a condition to the granting of such an extension, the Commissioner will usually require the taxpayer to furnish a bond on Form 1127B in an amount not exceeding double the amount of the deficiency or to furnish other security satisfactory to the Commissioner for the payment of the liability on or before the date or dates prescribed for payment in the extension, so that the risk of loss to the Government will not be greater at the end of the extension period than it was at the beginning of the period. If a bond is required it shall be conditioned upon the payment of the deficiency, interest, and additional amounts assessed in connection therewith in accordance with the terms of the extension granted, and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the Commissioner. In lieu of such a bond, the taxpayer may file a bond secured by deposit of bonds or notes of the United States as provided in section 1126 of the Revenue Act of 1926. The amount of the deficiency and additions thereto shall be paid on or before the expiration of the period of the extension without the necessity of notice and demand from the collector. Payment of the deficiency and additions thereto before the expiration of the extension will not relieve the taxpayer from paying the entire amount of interest provided for in the extension. (See section 296.)

SEC. 273. JEOPARDY ASSESSMENTS.

(a) *Authority for making.* If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he shall immediately assess such deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) and notice and demand shall be made by the collector for the payment thereof.

(b) *Deficiency letters.* If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 272 (a), then the Commissioner shall mail a notice under such subsection within sixty days after the making of the assessment.

(c) *Amount assessable before decision of Board.* The jeopardy assessment may be made in respect of a deficiency greater or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 272 (f) prohibiting the determination of additional deficiencies, and whether or not the taxpayer has theretofore filed a petition with the Board of Tax Appeals [known as The Tax Court of the United States]. The Commissioner may, at any time before the decision of the Board is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. The Commissioner shall notify the Board of the amount of such assessment, or abatement, if the petition is filed with the Board before the making of the assessment or is subsequently filed, and the Board shall have jurisdiction to redetermine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith.

(d) *Amount assessable after decision of Board.* If the jeopardy assessment is made after the decision of the Board is rendered such assessment may be made only in respect of the deficiency determined by the Board in its decision.

(e) *Expiration of right to assess.* A jeopardy assessment may not be made after the decision of the Board has become final or after the taxpayer has filed a petition for review of the decision of the Board.

(f) *Bond to stay collection.* When a jeopardy assessment has been made the taxpayer, within 10 days after notice and demand from the collector for the payment of the amount of the assessment, may obtain a stay of collection of the whole or any part of the amount of the assessment by filing with the collector a bond in such amount, not exceeding double the amount as to which the stay is desired, and with such sureties, as the collector deems necessary, conditioned upon the payment of so much of the amount, the collection of which is stayed by the bond, as is not abated by a decision of the Board which has become final, together with interest thereon as provided in section 297. If any portion of the jeopardy assessment is abated by the Commissioner before the decision of the Board is rendered, the bond shall, at the request of the taxpayer, be proportionately reduced.

(g) *Same; further conditions.* If the bond is given before the taxpayer has filed his petition with the Board under section 272 (a) the bond shall contain a further condition that if a petition is not filed within the period provided in such subsection, then the amount the collection of which is stayed by the bond will be paid on notice and demand at any time after the expiration of such period, together with interest thereon at the rate of 6 per centum per annum from the date of the jeopardy notice and demand to the date of notice and demand under this subsection.

(h) *Waiver of stay.* Upon the filing of the bond the collection of so much of the amount assessed as is covered by the bond shall be stayed. The taxpayer shall have the right to waive such stay at any time in respect of the whole or any part of the amount covered by the bond, and if as a result of such waiver any part of the amount covered by the bond is paid, then the bond shall, at the request of the taxpayer, be proportionately reduced. If the Board determines that the amount assessed is greater than the amount which should have been assessed, then when the decision of the Board is rendered the bond shall, at the request of the taxpayer, be proportionately reduced.

(i) *Collection of unpaid amounts.* When the petition has been filed with the Board and when the amount which should have been assessed has been determined by a decision of the Board which has become final, then any unpaid portion, the collection of which has been stayed by the bond, shall be collected as part of the tax upon notice and demand from the collector, and any remain-

ing portion of the assessment shall be abated. If the amount already collected exceeds the amount determined as the amount which should have been assessed, such excess shall be credited or refunded to the taxpayer as provided in section 322, without the filing of claim therefor. If the amount determined as the amount which should have been assessed is greater than the amount actually assessed, then the difference shall be assessed and shall be collected as part of the tax upon notice and demand from the collector.

(j) *Claims in abatement.* No claim in abatement shall be filed in respect of any assessment in respect of any tax imposed by this chapter.

§ 29.273–1 *Jeopardy assessments.* If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he is required to assess such deficiency immediately, together with the interest and other additional amounts provided by law. If a deficiency is assessed on account of jeopardy after the decision of The Tax Court of the United States is rendered, the jeopardy assessment may be made only with respect to the deficiency determined by The Tax Court. The Commissioner is prohibited from making a jeopardy assessment after a decision of The Tax Court has become final (see section 1140), or after the taxpayer has filed a petition for review of the decision of The Tax Court.

If notice of a deficiency was mailed to the taxpayer (see section 272 (a)) before it was discovered that delay would jeopardize the assessment or collection of the tax, a jeopardy assessment may be made in an amount greater or less than that included in the deficiency notice. On the other hand if the assessment on account of jeopardy was made without mailing the notice required by section 272 (a), the Commissioner must within 60 days after the making of the assessment send the taxpayer notice of the deficiency by registered mail. The taxpayer may file a petition with The Tax Court for a redetermination of the amount of the deficiency within 90 days after such notice is mailed (or within 150 days after mailing in the case of such a notice mailed after October 21, 1942, and addressed to a person outside the States of the Union and the District of Columbia), not counting Sunday or a legal holiday in the District of Columbia as the ninetieth or one hundred fiftieth day. The Commissioner may, at any time before the decision of The Tax Court is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. If the petition of the taxpayer is filed with The Tax Court, either before or after the making of the jeopardy assessment, the Commissioner is required to notify The Tax Court of such assessment or abatement, and The Tax Court has jurisdiction to redetermine the amount of the deficiency together with all other amounts assessed at the same time in connection therewith. (See section 273 (c).)

After a jeopardy assessment has been made, the list showing such assessment will be immediately transmitted to the collector. Upon receipt of the list containing the assessment, the collector is required to send notice and demand to the taxpayer for the amount of the jeopardy assessment. Regardless of whether the taxpayer has filed a petition with The Tax Court, he is required to make payment of the amount of such assessment (to the extent that it has not been abated) within 10 days after the sending of notice and demand by the collector, unless before the expiration of such 10-day period he files with the collector a bond on Form 1429 of the character hereinafter prescribed. The bond must be in such amount, not exceeding double the amount for which the stay is desired, as the collector deems necessary and must be executed by sureties satisfactory to the collector. It must be conditioned upon the payment of so much of the amount included therein as is not abated by a decision of The Tax Court which has become final, together with the interest on such amount provided for in section 297. If the bond is given before the taxpayer has filed his petition with The Tax Court, it must contain a further condition that if a petition is not filed before the expiration of the 90-day or 150-day period provided for the filing of such petition, the amount stayed by the bond will be paid upon notice and demand at any time after the expiration of such period, together with interest thereon at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of the notice and demand made after the expiration of the 90-day or 150-day period. If a petition is not filed with The Tax Court within the 90-day or 150-day period, the collector will be so advised, and, if collection of the deficiency has been stayed by the filing of a bond within 10 days after the date of jeopardy notice and demand, he should then give notice and make demand for payment of the amount assessed plus interest. Any bond filed after the expiration of 10 days from the date of the jeopardy notice and demand is not such a bond as is contemplated by section 273 (f), and, while the collector may in his discretion accept the bond and stay collection of the deficiency, the taxpayer will not be relieved from payment of interest on the amount of the deficiency at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of payment.

Upon the filing of a bond of the character described within 10 days after the date of notice and demand for payment of the amount assessed, the collection of so much thereof as is covered by the bond will be stayed. The taxpayer may at any time waive the stay of collection of the whole or any part of the amount covered by the bond. If as a result of such waiver any part of the amount covered by the bond is paid, or if any portion of the jeopardy assessment is abated by the Commissioner before the decision of The Tax Court is rendered, then the bond shall at the request of the taxpayer be proportionately reduced. If The Tax Court determines that the amount assessed is greater than the correct amount of the tax, the bond will also be proportionately reduced at the request of the taxpayer after The Tax Court renders its decision.

After The Tax Court has rendered its decision and such decision has become final, the collector will be notified of the action taken. The collector will then send notice and demand for the unpaid portion of the amount determined by The Tax Court, the collection of which has been stayed by the bond. The collector is required to include in the notice and demand for the unpaid portion, interest at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of the notice and demand referred to in this paragraph. If the amount of the jeopardy assessment is less than the amount determined by The Tax Court, the difference, together with interest as provided in section 292, will be assessed, and collected as part of the tax upon notice and demand from the collector. If the amount included in the notice and demand made after the decision of The Tax Court is not paid within 10 days after such notice and demand, there shall be collected as part of the tax, interest as provided in section 294 (b). If the amount of the jeopardy assessment is in excess of the amount determined by The Tax Court, the unpaid portion of such excess will be abated. If any part of the excess amount has been paid, it will be credited or refunded to the taxpayer as provided in section 322.

As to bankruptcy, proceedings for the relief of debtors and receivership cases, see sections 274 and 298 and §§ 29.274–1 and 29.274–2.

SEC. 274. BANKRUPTCY AND RECEIVERSHIPS.

(a) *Immediate assessment.* Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) determined by the Commissioner in respect of a tax imposed by this chapter upon such taxpayer shall, despite the restrictions imposed by section 272 (a) upon assessments be immediately assessed if such deficiency has not theretofore been assessed in accordance with law. In such cases the trustee in bankruptcy or receiver shall give notice in writing to the Commissioner of the adjudication of bankruptcy or the appointment of the receiver, and the running of the statute of limitations on the making of assessments shall be suspended for the period from the date of adjudication in bankruptcy or the appointment of the receiver to a date 30 days after the date upon which the notice from the trustee or receiver is received by the Commissioner; but the suspension under this sentence shall in no case be for a period in excess of two years. Claims for the deficiency and such interest, additional amounts and additions to the tax may be presented, for adjudication in accordance with law, to the court before which the bankruptcy or receivership proceeding is pending, despite the pendency of proceedings for the redetermination of the deficiency in pursuance of a petition to the Board [known as The Tax Court of the United States]; but no petition for any such redetermination shall be filed with the Board after the adjudication of bankruptcy or the appointment of the receiver.

(b) *Unpaid claims.* Any portion of the claim allowed in such bankruptcy or receivership proceeding which is unpaid shall be paid by the taxpayer upon notice and demand from the collector after the termination of such proceeding, and may be collected by distraint or proceeding in court within 6 years after termination of such proceeding. Extensions of time for such payment may be had in the same manner and subject to the same provisions and limitations as are provided in section 272 (j) and section 296 in the case of a deficiency in a tax imposed by this chapter.

§ 29.274–1 *Bankruptcy and receivership proceedings.* During a bankruptcy proceeding, or an equity receivership proceeding in either a Federal or a State court, the assets of the taxpayer are in general under the control of the court in which such proceeding is pending, and the collection of taxes cannot be made by distraining upon such assets. However, any assets which under applicable provisions of law are not under the control of the court may be subject to distraint.

As used in these regulations the term "bankruptcy proceeding" includes proceedings under Chapters I to VII of the Bankruptcy Act, as amended, or under section 74, 75, 77, or 77B, or Chapters X to XIII, or Chapter XV, of such Act, as amended; and the term "adjudication of bankruptcy" includes, in addition to an adjudication in a proceeding under Chapters I to VII, the approval of a petition as properly filed under section 77 or 77B or Chapter X by a court of competent jurisdiction or the filing of a petition under section 74 or 75 or Chapters XI to XIII or Chapter XV with a court of competent jurisdiction.

A trustee in bankruptcy (including a trustee, receiver, debtor in possession, or other person designated as in control of the assets of a debtor in any bankruptcy proceeding by order of the court in which such proceeding is pending) or a receiver in any receivership proceeding is required to give notice in writing to the Commissioner of Internal Revenue in Washington, D. C., of the adjudication of bankruptcy or the appointment of a receiver. (See section 274 (a) and § 29.275–1.)

Collectors should, promptly after notice of outstanding liability against a taxpayer in any bankruptcy or receivership proceeding, and in any event within the time limited by the appropriate provisions of the Bankruptcy Act, as amended, and the orders of the court in which such proceeding is pending, file claim covering such liability in the court in which such proceeding is pending. Such claim should be filed whether the unpaid taxes involved have been assessed or not, except in cases where the departmental instructions direct otherwise; for example, where the payment of the taxes is secured by a sufficient bond. Such claims should cover the amount represented by the assessment, plus interest at the rate of 6 percent per annum for the period from the date of filing claim by the collector to the date of termination of the bankruptcy or receivership proceeding or to the date of payment if payment is made in full prior to such termination. At the same time claim is filed with the bankruptcy or receivership court, the collector will send notice and demand for payment to the taxpayer together with a copy of such claim.

Under section 3466 of the Revised Statutes and section 3467 of the Revised Statutes, as amended, and section 64 of the Bankruptcy Act, as amended, taxes are entitled to the priority over other claims therein stated and the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which bankruptcy or receivership proceeding is pending, may be held personally liable for failure on his part to protect the priority of the Government respecting taxes of which he has notice. Bankruptcy courts have jurisdiction under the Bankruptcy Act, as amended, to determine all disputes regarding the amount and validity of taxes of a bankrupt or of a debtor in a proceeding under the Bankruptcy Act, as amended. A bankruptcy or receivership proceeding does not discharge any portion of a claim of the United States for taxes except in the case of a proceeding under Chapter X of the Bankruptcy Act, as amended, and except to the extent which may be provided in a plan or arrangement duly effectuated in a bankruptcy proceeding; and any portion of a claim of the United States for taxes which has been allowed by the court in which the bankruptcy or receivership proceeding is pending and which remains unsatisfied after the termination of the bankruptcy or receivership proceeding shall be collected with interest as provided in section 298.

§ 29.274–2 *Immediate assessments in bankruptcy and receivership cases.* If the Commissioner has determined that a deficiency is due in respect of income tax and the taxpayer has filed a petition with The Tax Court of the United States prior to the adjudication of bankruptcy or the appointment of a receiver, the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which the bankruptcy or receivership proceeding is pending, may prosecute the taxpayer's appeal before The Tax Court as to that particular determination. No petition shall be filed with The Tax Court for a redetermination of the deficiency after the adjudication of bankruptcy or the appointment of a receiver.

Claim for the amount of a deficiency, even though pending before The Tax Court for consideration, may be filed with the court in which the bankruptcy or receivership proceeding is pending without awaiting final decision of The Tax Court. In case of final decision of The Tax Court before the termination of the bankruptcy, debtor, or receivership proceeding, a copy of The Tax Court's decision may be filed by the Commissioner with the court in which such proceeding is pending.

While the Commissioner is required by section 274 to make immediate assessment of any deficiency, such assessment is not made as a jeopardy assessment within the meaning of section 273, and consequently the provisions of that section do not apply to any assessment made under section 274. Therefore, the notice of the deficiency provided for in section 273 (b) will not be mailed. Although such notice will not be issued, nevertheless a letter will be sent to the taxpayer, or to the trustee, receiver, debtor in possession, or other person designated by the court in which the bankruptcy or receivership proceeding is pending as in control of the assets of the debtor, notifying him in detail how the deficiency was computed, that he may furnish evidence showing wherein the deficiency is incorrect, and that upon request he will be granted a hearing with repect to such deficiency. If after such evidence is submitted and hearing held any adjustment appears necessary in the deficiency, appropriate action will be taken. A copy of the notification letter will be attached to the assessment list as the collector's authority for filing claim in any bankruptcy or receivership proceeding.

If any portion of the claim allowed by the court in a bankruptcy or receivership proceeding remains unpaid after the termination of such proceeding, the collector will send notice and demand for payment thereof to the taxpayer. Such unpaid portion with interest as provided in section 298 may be collected from the taxpayer by distraint or proceeding in court within six years after the termination of the bankruptcy or receivership proceeding. Extensions of time for the payment of such unpaid amount may be granted in the same manner and subject to the same provisions and limitations as provided in sections 272 (j) and 297. (See § 29.272–3.)

This section deals only with immediate assessments provided for in section 274 and the procedure in connection with such assessments.

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION [as amended by sec. 503, 2d Rev. Act 1940].

Except as provided in section 276—

(a) *General rule.* The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(b) *Request for prompt assessment.* In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, or by a corporation, the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within eighteen months after written request therefor (filed after the return is made) by the executor, administrator, or other fiduciary representing the estate of such decedent, or by the corporation, but not after the expiration of three years after the return was filed. This subsection shall not apply in the case of a corporation unless—

(1) Such written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such 18 months' period; and

(2) The dissolution is in good faith begun before the expiration of such 18 months' period; and

(3) The dissolution is completed.

(c) *Omission from gross income.* If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross

income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

(d) *Constructive dividends.* If the taxpayer omits from gross income an amount properly includible therein—

(1) *Foreign personal-holding companies.* Under section 337 (b) (relating to the inclusion in the gross income of United States shareholders of their distributive shares of the undistributed Supplement P net income of a foreign personal-holding company); or

(2) *Personal service corporations.* Under section 394 (b) (relating to the inclusion in the gross income of shareholders of their distributive shares of undistributed Supplement S net income of a personal service corporation):

the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within seven years after the return was filed.

(e) *Distributions in liquidation to shareholders.* If the taxpayer omits from gross income an amount properly includible therein under section 115 (c) as an amount distributed in liquidation of a corporation, other than a foreign personal holding company, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within four years after the return was filed.

(f) For the purposes of subsections (a), (b), (c), (d), and (e), a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

(g) *Corporation and shareholder.* If a corporation makes no return of the tax imposed by this chapter, but each of the shareholders includes in his return his distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

SEC. 276. SAME; EXCEPTIONS.

(a) *False return or no return.* In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) *Waiver.* Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(c) *Collection after assessment.* Where the assessment of any income tax imposed by this chapter has been made within the period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such six-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

SEC. 277. SUSPENSION OR RUNNING OF STATUTE.

The running of the statute of limitations provided in section 275 or 276 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under section 272 (a)) be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board [known as The Tax Court of the United States], until the decision of the Board becomes final), and for sixty days thereafter.

§ 29.275–1 *Period of limitation upon assessment of tax.* The amount of income tax imposed by the Internal Revenue Code must be assessed within three years after the return was filed. For the purposes of subsections (a), (b), (c), (d), and (e) of section 275, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. Exceptions to the period of limitation stated in this paragraph (other than those provided for elsewhere in the Code) are as follows:

(a) In the case of income received during the lifetime of a decedent or by his estate during the period of administration, or by a corporation contemplating dissolution, the tax shall be assessed within 18 months after written request therefor by the fiduciary or legal representative of the estate of the decedent or by the corporation, but not after the expiration of three years after the return was filed. The effect of this provision is to limit the period in which the Commissioner may assess the tax in such cases to a period of 18 months from the date the request is filed, even though more than 18 months still remain of the regular 3-year period in which the assessment may under ordinary circumstances be made. The request, in order to be effective, must be made after the return is filed and must be in such language as to make it clear to the Commissioner that it is desired to take advantage of the provisions of section 275 (b). In the case of a corporation the 18-month period of limitation shall not apply unless:

(1) The written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such period,

(2) The dissolution is in good faith begun before the expiration of such period, and

(3) The dissolution so begun is completed either before or after the expiration of such 18-month period.

Such a request does not have the effect of extending the regular period of limitation even though the request is made less than 18 months before the expiration of the regular period of limitation.

(b) If a corporation makes no income tax return under the Internal Revenue Code, but each of the shareholders includes in his personal return his distributive share of the net income of the corporation, the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

(c) In the case of a false or fraudulent return with intent to evade tax, the tax may be assessed at any time after such false or fraudulent return is filed.

(d) If there is omitted from the gross income stated in the return an amount properly includible therein which is in excess of 25 percent of the gross income so stated, the tax may be assessed at any time within five years after the return was filed.

(e) In the event the taxpayer fails to file a return, the amount of tax due may be assessed at any time after the date prescribed for filing the return. (But see paragraph (b) of this section.)

(f) If the taxpayer omits from gross income an amount properly includible therein under section 337 (b) as his distributive share of the undistributed Supplement P net income of a foreign personal holding company (see sections 331 to 340, inclusive) or an amount properly includible therein under section 394 (b) as his distributive share of the Supplement S net income of a personal service corporation (see sections 391 to 396, inclusive), the tax may be assessed at any time within seven years after the return was filed.

(g) If the taxpayer omits from gross income an amount properly includible therein under section 115 (c) as an amount distributed in liquidation of a corporation, other than a foreign personal holding company, the tax may be assessed at any time within four years after the return was filed.

(h) If before the expiration of the time prescribed in section 275 for the assessment of the tax the Commissioner and the taxpayer have consented in writing to the assessment of the tax after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(i) If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a), then the running of the statute of limitations on assessment of any deficiency shall be suspended for the period during which the Commissioner is prohibited from making the assessment (and in any event, if a proceeding in respect of the deficiency is placed on the docket of The Tax Court of the United States, until the decision of The Tax Court becomes final), and for 60 days thereafter. If the Commissioner mails to a taxpayer a notice of deficiency within the statutory period of limitation and the taxpayer does not appeal therefrom to The Tax Court, the notice of deficiency so given does not suspend the running of the period of limitation on assessment for the purpose of any additional deficiency shown to be due in a subsequent deficiency notice.

(j) In a bankruptcy or receivership proceeding the running of the statute of limitations on the making of assessments is suspended from the date of adjudication in bankruptcy or the date of the appointment of a receiver, as the case may be, to a date 30 days after the date upon which the notice provided for in section 274 (a) is received by the Commissioner in Washington, D. C., but in no case shall the suspension be for a period in excess of two years. See section 274 (a) and §§ 29.274–1 and 29.274–2.

With respect to the period of limitation for assessing the amount of the liability of a transferee of property, or for assessing the amount of the liability of a fidu-

ciary under section 3467 of the Revised Statutes, as amended, see section 311.

§ 29.275–2 *Period of limitation upon collection of tax.* In the case of the income taxes imposed by the Internal Revenue Code, a proceeding in court without assessment for the collection of such tax must be begun within three years after the return was filed.

The exceptions to the period of limitation upon collection of the tax without assessment stated in the preceding paragraph are as follows:

(a) In the case of income received during the lifetime of a decedent or by his estate during the period of administration, or by a corporation, a proceeding in court for the collection of the tax without assessment must be begun within 18 months after a written request therefor by the executor, administrator, or other fiduciary representing the estate of the decedent, or by the corporation, but not after the expiration of three years after the return was filed. Such a request does not have the effect of extending the regular period of limitation within which a proceeding in court without assessment may be begun, even though the request is made less than 18 months before the expiration of the regular period of limitation, nor is it of any effect if made before the return is filed. In the case of a corporation the conditions stated in paragraph (a)(1), (a)(2), and (a) (3) of § 29.275–1 also must be met.

(b) A proceeding in court for the collection of the tax without assessment may be begun at any time:

(1) In case the taxpayer files a false or fraudulent return with intent to evade tax; or

(2) In case the taxpayer fails to file a return.

(c) If there is omitted from the gross income stated in the return an amount properly includible therein which is in excess of 25 percent of the gross income so stated, a proceeding in court for the collection of the tax may be begun without assessment at any time within five years after the return was filed.

(d) If the taxpayer omits from gross income an amount properly includible therein under section 337 (b) as his distributive share of the undistributed Supplement P net income of a foreign personal holding company (see sections 331 to 340, inclusive), or an amount properly includible therein under section 394 (b) as his distributive share of the Supplement S net income of a personal service corporation (see sections 391 to 396, inclusive), a proceeding in court for the collection of the tax may be begun without assessment at any time within seven years after the return was filed.

(e) If the taxpayer omits from gross income an amount properly includible therein under section 115 (c) as an amount distributed in liquidation of a corporation, other than a foreign personal holding company, a proceeding in court for the collection of the tax may be begun without assessment at any time within four years after the return was filed.

In any case in which the tax has been assessed within the statutory period of limitation properly applicable thereto, a proceeding in court or distraint for the collection of such tax may be begun within six years after the assessment thereof, or prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such 6-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. In determining the running of the statute of limitations in respect of distraint, the distraint shall be held to have been begun, in the case of personal property, on the date on which the levy upon such property is made, or, in the case of real property, on the date on which notice of the time and place of sale is given to the person whose estate it is proposed to sell.

If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see § 29.272–1), then the running of the statute of limitations on the beginning of distraint after assessment, or on the beginning of a proceeding in court after assessment or without assessment, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from beginning such distraint or proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of The Tax Court of the United States, until the decision of the Tax Court becomes final), and for 60 days thereafter.

With respect to the period of limitation upon the collection of the tax on unpaid claims in bankruptcy or receivership proceedings, see section 274 (b) and § 29.274–2.

INTEREST AND ADDITIONS TO THE TAX

SEC. 291. FAILURE TO FILE RETURN [as amended by sec. 172 (f), Rev. Act 1942].

(a) In case of any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amounts so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3612 (d) (1).

(b) For minimum addition to the tax for failure of withholding agent to make and file return required by Part II of Subchapter D,[1] see section 470 (c).

§ 29.291–1 *Addition to the tax in case of failure to file return.* In case of failure to make and file a return required by chapter 1 within the prescribed time, a certain percent of the amount of the tax is added to the tax unless failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. The amount to be added to the tax is 5 percent if the failure is for not more than 30 days, with an additional 5 percent for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 percent in the aggregate.

A taxpayer who wishes to avoid the addition to the tax for delinquency must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be filed with the collector, who, unless otherwise directed by the Commissioner, will forward the affidavit to the Commissioner, and, if the Commissioner determines that the delinquency was due to a reasonable cause, and not to willful neglect, the addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause.

If the addition to the tax for delinquency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

For addition to the tax in case of a deficiency due to fraud with intent to evade tax, see section 293. As to the making of returns for taxpayers by collectors or the Commissioner in the case of delinquency in filing a return, or in the case of a false or fraudulent return, see section 3612.

SEC. 292. INTEREST ON DEFICIENCIES.

Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, or, in the case of a waiver under section 272 (d), to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier.

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(a) *Negligence.* If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272 (i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

(b) *Fraud.* If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).

SEC. 294. ADDITIONS TO THE TAX IN CASE OF NONPAYMENT [as amended by sec. 5 (b), Current Tax Payment Act 1943.]

[1] Subchapter D of chapter 1.

(a) *Tax shown on return*—(1) *General rule.* Where the amount determined by the taxpayer as the tax imposed by this chapter, or any installment thereof, or any part of such amount or installment, is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of 6 per centum per annum from the date prescribed for its payment until it is paid.

(2) *If extension granted.* Where an extension of time for payment of the amount so determined as the tax by the taxpayer, or any installment thereof, has been granted, and the amount the time for payment of which has been extended, and the interest thereon determined under section 295, is not paid in full prior to the expiration of the period of the extension, then, in lieu of the interest provided for in paragraph (1) of this subsection, interest at the rate of 6 per centum per annum shall be collected on such unpaid amount from the date of the expiration of the period of the extension until it is paid.

(3) *Failure to file declaration of estimated tax.* In the case of a failure to make and file a declaration of estimated tax within the time prescribed, there shall be added to the tax an amount equal to 10 per centum of the tax. [NOTE.—Under sec. 5 (f), Current Tax Payment Act 1943, this provision is effective with respect to taxable years beginning after December 31, 1942.]

(4) *Failure to pay installment of estimated tax.* In the case of the failure to pay an installment of the estimated tax within the time prescribed, there shall be added to the tax $2.50 or 2½ per centum of the tax, whichever is the greater, for each installment with respect to which such failure occurs. [NOTE: Under sec. 5 (f), Current Tax Payment Act 1943, this provision is effective with respect to taxable years beginning after December 31, 1942.]

(5) *Substantial underestimate of estimated tax.* If 80 per centum of the tax (determined without regard to the credits under sections 32, 35, and 466 (e)), in the case of individuals other than farmers exercising an election under section 60 (a), or 66⅔ per centum of such tax so determined in the case of such farmers, exceeds the estimated tax (increased by such credits), there shall be added to the tax an amount equal to such excess, or equal to 6 per centum of the amount by which such tax so determined exceeds the estimated tax so increased, whichever is the lesser. This paragraph shall not apply to the taxable year in which falls the death of the taxpayer. [NOTE: Under sec. 5 (f), Current Tax Payment Act 1943, this provision is effective with respect to taxable years beginning after December 31, 1942, but is not applicable to a taxable year beginning in 1943 in the case of an individual not required to make a declaration under section 58, Internal Revenue Code, for such year.]

(b) *Deficiency.* Where a deficiency, or any interest or additional amounts assessed in connection therewith under section 292, or under section 293, or any addition to the tax in case of delinquency provided for in section 291, is not paid in full within ten days from the date of notice and demand from the collector, there shall be collected as part of the tax, interest upon the unpaid amount at the rate of 6 per centum per annum from the date of such notice and demand until it is paid. If any part of a deficiency prorated to any unpaid installment under section 272 (l) is not paid in full on or before the date prescribed for the payment of such installment, there shall be collected as part of the tax interest upon the unpaid amount at the rate of 6 per centum per annum from such date until it is paid.

(c) *Filing of jeopardy bond.* If a bond is filed, as provided in section 273, the provisions of subsection (b) of this section shall not apply to the amount covered by the bond.

SEC. 295. TIME EXTENDED FOR PAYMENT OF TAX SHOWN ON RETURN.

If the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, is extended under the authority of section 56 (c), there shall be collected as a part of such amount, interest thereon at the rate of 6 per centum per annum from the date when such payment should have been made if no extension had been granted, until the expiration of the period of the extension.

SEC. 296. TIME EXTENDED FOR PAYMENT OF DEFICIENCY.

If the time for the payment of any part of a deficiency is extended, there shall be collected, as a part of the tax, interest on the part of the deficiency the time for payment of which is so extended, at the rate of 6 per centum per annum for the period of the extension, and no other interest shall be collected on such part of the deficiency for such period. If the part of the deficiency the time for payment of which is so extended is not paid in accordance with the terms of the extension, there shall be collected, as a part of the tax, interest on such unpaid amount at the rate of 6 per centum per annum for the period from the time fixed by the terms of the extension for its payment until it is paid, and no other interest shall be collected on such unpaid amount for such period.

SEC. 297. INTEREST IN CASE OF JEOPARDY ASSESSMENTS.

In the case of the amount collected under section 273 (i) there shall be collected at the same time as such amount, and as a part of the tax, interest at the rate of 6 per centum per annum upon such amount from the date of the jeopardy notice and demand to the date of notice and demand under section 273 (i), or, in the case of the amount collected in excess of the amount of the jeopardy assessment, interest as provided in section 292. If the amount included in the notice and demand from the collector under section 273 (i) is not paid in full within ten days after such notice and demand, then there shall be collected, as part of the tax, interest upon the unpaid amount at the rate of 6 per centum per annum from the date of such notice and demand until it is paid.

SEC. 298. BANKRUPTCY AND RECEIVERSHIPS.

If the unpaid portion of the claim allowed in a bankruptcy or receivership proceeding, as provided in section 274, is not paid in full within ten days from the date of notice and demand from the collector, then there shall be collected as a part of such amount interest upon the unpaid portion thereof at the rate of 6 per centum per annum from the date of such notice and demand until payment.

SEC. 299. REMOVAL OF PROPERTY OR DEPARTURE FROM UNITED STATES.

For additions to tax in case of leaving the United States or concealing property in such manner as to hinder collection of the tax, see section 146.

CLAIMS AGAINST TRANSFEREES AND FIDUCIARIES

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of collection.* The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.* The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

(2) *Fiduciaries.* The liability of a fiduciary under section 3467 of the Revised Statutes, as amended, (U. S. C., Title 31, § 192) in respect of the payment of any such tax from the estate of the taxpayer.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) *Period of limitation.* The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer,—within one year after the expiration of the period of limitation for assessment against the taxpayer;

(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer,—within one year after the expiration of the period of limitation for assessment against the preceding transferee, but only if within three years after the expiration of the period of limitation for assessment against the taxpayer;—

except that if before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the taxpayer or last preceding transferee, respectively,—then the period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding.

(3) In the case of the liability of a fiduciary,—not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later;

(4) Where before the expiration of the time prescribed in paragraph (1), (2), or (3) for the assessment of the liability, both the Commissioner and the transferee or fiduciary have consented in writing to its assessment after such time, the liability may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(c) *Period for assessment against taxpayer.* For the purposes of this section, if the taxpayer is deceased, or in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had death or termination of existence not occurred.

(d) *Suspension of running of statute of limitations.* The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing to the transferee or fiduciary of the notice provided for in section 272 (a), be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board [known as The Tax Court of the United States], until the decision of the Board becomes final), and for sixty days thereafter.

(e) *Address for notice of liability.* In the absence of notice to the Commissioner under section 312 (b) of the existence of a fiduciary relationship, notice of liability enforceable under this section in respect of a tax imposed by this chapter, if mailed to the person subject to the liability at his last known address, shall be sufficient for the purposes of this chapter even if such person is deceased, or is under a legal disability, or,

in the case of a corporation, has terminated its existence.

(f) *Definition of "transferee".* As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

§ 29.311–1 *Claims in cases of transferred assets.* The amount for which a transferee of the property of a taxpayer is liable, at law or in equity, and the amount of the personal liability of a fiduciary under section 3467 of the Revised Statutes, as amended, in respect of any income tax imposed by chapter 1, whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by chapter 1, except as hereinafter provided. The provisions relating to delinquency in payment after notice and demand and the amount of interest attaching because of such delinquency, the authorization of distraint and proceedings in court for collection, the prohibition of claims for abatement and claims and suits for refund, the filing of a petition with The Tax Court of the United States, and the filing of a petition for review of The Tax Court's decision, are included in the sections of the Internal Revenue Code (and regulations pertaining thereto) relating to deficiencies in the tax imposed by chapter 1.

The term "transferee" as used in this section includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, and all other classes of distributees.

The period of limitation for assessment of the liability of a transferee or of a fiduciary, referred to in the first paragraph of this section, is as follows:

(a) In the case of the liability of an initial transferee of the property of the taxpayer, one year after the expiration of the period of limitation for assessment against the taxpayer (see sections 275 to 277, inclusive);

(b) In the case of the liability of a transferee or a transferee of the property of the taxpayer, one year after the expiration of the period of limitation for assessment against the preceding transferee, or three years after the expiration of the period of limitation for assessment against the taxpayer, whichever of the two periods (the 1-year period or the 3-year period) first expires;

(c) If a court proceeding against the taxpayer or last preceding transferee for the collection of the tax or liability in respect thereof, respectively, has been begun within the period of limitation for the bringing of such proceeding, then within one year after the return of execution in such proceeding; and

(d) In the case of the liability of a fiduciary, not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later.

(e) If before the expiration of the time prescribed in section 311 (b) (1), (2), or (3) for the assessment of the liability of a transferee or fiduciary, both the Commissioner and the transferee or fiduciary have consented in writing to the assessment of the liability after such time, the liability may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

For the purpose of determining the period of limitation for assessment against a transferee or a fiduciary, if the taxpayer is deceased, or, in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

If a notice of the liability of a transferee or the liability of a fiduciary has been mailed to such transferee or to such fiduciary under the provisions of section 272 (a), then the running of the statute of limitations shall be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of The Tax Court, until the decision of The Tax Court becomes final), and for 60 days thereafter.

SEC. 312. NOTICE OF FIDUCIARY RELATIONSHIP.

(a) *Fiduciary of taxpayer.* Upon notice to the Commissioner that any person is acting in a fiduciary capacity such fiduciary shall assume the powers, rights, duties, and privileges of the taxpayer in respect of a tax imposed by this chapter (except as otherwise specifically provided and except that the tax shall be collected from the estate of the taxpayer), until notice is given that the fiduciary capacity has terminated.

(b) *Fiduciary of transferee.* Upon notice to the Commissioner that any person is acting in a fiduciary capacity for a person subject to the liability specified in section 311, the fiduciary shall assume, on behalf of such person, the powers, rights, duties, and privileges of such person under such section (except that the liability shall be collected from the estate of such person), until notice is given that the fiduciary capacity has terminated.

(c) *Manner of notice.* Notice under subsection (a) or (b) shall be given in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

§ 29.312–1 *Fiduciaries.* As soon as the Commissioner receives notice that a person is acting in a fiduciary capacity, such fiduciary must, except as otherwise specifically provided, assume the powers, rights, duties, and privileges of the taxpayer with respect to income tax imposed by chapter 1. If the person is acting as a fiduciary for a transferee or other person subject to the liability specified in section 311, such fiduciary is required to assume the powers, rights, duties, and privileges of the transferee or other person under that section. The amount of the tax or liability is ordinarily not collectible from the personal estate of the fiduciary but is collectible from the estate of the taxpayer or from the estate of the transferee or other person subject to the liability specified in section 311. The "notice to the Commissioner" provided for in section 312 shall be a written notice signed by the fiduciary and filed with the Commissioner. The notice must state the name and address of the person for whom the fiduciary is acting, and the nature of the liability of such person; that is, whether it is a liability for tax, and, if so, the year or years involved, or a liability at law or in equity of a transferee of property of a taxpayer, or a liability of a fiduciary under section 3467 of the Revised Statutes, as amended, in respect of the payment of any tax from the estate of the taxpayer. Any such written notice which has been filed with the Commissioner since the enactment of the Revenue Act of 1926 shall be considered as sufficient notice to the Commissioner within the meaning of section 312. Unless there is already on file with the Commissioner satisfactory evidence of the authority of the fiduciary to act for such person in a fiduciary capacity, such evidence must be filed with and made a part of the notice. If the fiduciary capacity exists by order of court, a certified copy of the order may be regarded as such satisfactory evidence. When the fiduciary capacity has terminated, the fiduciary in order to be relieved of any further duty or liability as such, must file with the Commissioner written notice that the fiduciary capacity has terminated as to him, accompanied by satisfactory evidence of the termination of the fiduciary capacity. The notice of termination should state the name and address of the person, if any, who has been substituted as fiduciary.

If the notice of the fiduciary capacity described in the preceding paragraph is not filed with the Commissioner prior to the sending of notice of a deficiency by registered mail to the last known address of the taxpayer (see section 272 (a)), or the last known address of the transferee or other person subject to liability (see section 311), no notice of the deficiency will be sent to the fiduciary. In such a case the sending of the notice to the last known address of the taxpayer, transferee, or other person, as the case may be, will be a sufficient compliance with the requirements of the Internal Revenue Code, even though such taxpayer, transferee, or other person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence. Under such circumstances, if no petition is filed with The Tax Court of the United States within 90 days after the mailing of the notice (or within 150 days after mailing in the case of such a notice mailed after October 21, 1942, and addressed to a person outside the States of the Union and the District of Columbia) to the taxpayer, transferee, or other person, the tax, or liability under section 311, will be assessed immediately upon the expiration of such 90-day or 150-day period, and demand for payment will be made by the collector. The term "fiduciary" is defined in section 3797 (a) (6) to mean a guardian, trustee, executor, administrator, receiver, conservator, or any person

acting in any fiduciary capacity for any person.

This section, relating to the provisions of section 312, shall not be taken to abridge in any way the powers and duties of fiduciaries provided for in other sections of the Internal Revenue Code.

SEC. 313. CROSS REFERENCE.

For prohibition of suits to restrain enforcement of liability of transferee or fiduciary, see section 3653 (b).

OVERPAYMENTS

SEC. 321. OVERPAYMENT OF INSTALLMENT.

If the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the overpayment shall be credited or refunded as provided in section 322.

SEC. 322. REFUNDS AND CREDITS [as amended by secs. 169 (a) (b), 172 (e), Rev. Act 1942; secs. 2 (b), 4 (a) (b), Current Tax Payment Act 1943].

(a) *Authorization*—(1) *Overpayment.* Where there has been an overpayment of any tax imposed by this chapter, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance shall be refunded immediately to the taxpayer.

(2) *Excessive withholding.* Where the amount of the tax withheld at the source under Part II of Subchapter D or Subchapter D of Chapter 9 exceeds the taxes imposed by this chapter against which the tax so withheld may be credited under section 35 or 466 (e), the amount of such excess shall be considered an overpayment.

(3) *Credits against estimated tax.* The Commissioner is authorized to prescribe, with the approval of the Secretary, regulations providing for the crediting against the estimated tax for any taxable year of the amount determined by the taxpayer or the Commissioner to be an overpayment of the tax for a preceding taxable year.

(b) *Limitation on allowance*—(1) *Period of limitation.* Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(2) *Limit on amount of credit or refund.* The amount of the credit or refund shall not exceed the portion of the tax paid—

(A) If a return was filed by the taxpayer, and the claim was filed within three years from the time the return was filed, during the three years immediately preceding the filing of the claim.

(B) If a claim was filed, and (i) no return was filed, or (ii) if the claim was not filed within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the filing of the claim.

(C) If no claim was filed and the allowance of credit or refund is made within three years from the time the return was filed by the taxpayer, during the three years immediately preceding the allowance of the credit or refund.

(D) If no claim was filed, and (i) no return was filed or (ii) the allowance of the credit or refund is not made within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the allowance of the credit or refund.

(3) *Exceptions in the case of waivers.* If both the Commissioner and the taxpayer have, within the period prescribed in paragraph (1) for the filing of a claim for credit or refund, agreed in writing under the provisions of section 276 (b) to extend beyond the period prescribed in section 275 the time within which the Commissioner may make an assessment, the period within which a claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, shall be the period within which the Commissioner may make an assessment pursuant to such agreement or any extension thereof, and six months thereafter, except that the provisions of paragraph (1) shall apply to any claim filed, or credit or refund allowed or made, before the execution of such agreement. The amount of the credit or refund shall not exceed the total of the portions of tax paid (A) during the two years immediately preceding the execution of such agreement, or, if such agreement was executed within three years from the time the return was filed, during the three years immediately preceding the execution of such agreement, (B) after the execution of the agreement and before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, and (C) during six months after the expiration of such period, except that the provisions of paragraph (2) shall apply to any claim filed, or credit or refund allowed, before the execution of the agreement. If any portion of the tax is paid after the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement, and if no claim for credit or refund is filed after the time of such payment and before the end of six months after the expiration of such period, then credit or refund may be allowed or made if a claim therefor is filed by the taxpayer within six months from the time of such payment, or, if no claim is filed within such six-month period after the payment, if the credit or refund is allowed or made within such period, but the amount of the credit or refund shall not exceed the portion of the tax paid during the six months immediately preceding the filing of the claim, or, if no claim was filed (and the credit or refund is allowed after six months after the expiration of the period within which the Commissioner might make an assessment), during the six months immediately preceding the allowance of the credit or refund.

(4) *Return considered filed on due date.* For the purposes of this subsection, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. For the purposes of paragraphs (2) and (3) of this subsection, and for the purposes of subsection (d) of this section, an advance payment of any portion of the tax made at the time such return was filed shall be considered as made on the last day prescribed by law for the payment of the tax or, if the taxpayer elected to pay the tax in installments, on the last day prescribed for the payment of the first installment. For the purposes of this paragraph, the last day prescribed by law for filing the return or paying the tax shall be determined without regard to any extension of time granted the taxpayer.

(5) *Special period of limitation with respect to bad debts and worthless securities.* If the claim for credit or refund relates to an overpayment on account of—

(A) the deductibility by the taxpayer, under section 23 (k) (1), section 23 (k) (4), or section 204 (c), of a debt as a debt which became worthless, or, under section 23 (g) (2) or (k) (2), of a loss from worthlessness of a security, or

(B) the effect that the deductibility of a debt or loss described in subparagraph (A) has on the application to the taxpayer of a carry-over or of a carry-back,

in lieu of the three-year period of limitation prescribed in paragraph (1), the period shall be 7 years from the date prescribed by law for filing the return for the year with respect to which the claim is made. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in paragraph (2) or paragraph (3), whichever is applicable, to the extent of the amount of the overpayment attributable to the deductibility of items described in this paragraph.

(c) *Effect of petition to Board.* If the Commissioner has mailed to the taxpayer a notice of deficiency under section 272 (a) and if the taxpayer files a petition with the Board of Tax Appeals [known as The Tax Court of the United States] within the time prescribed in such subsection, no credit or refund in respect of the tax for the taxable year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except—

(1) As to overpayments determined by a decision of the Board which has become final; and

(2) As to any amount collected in excess of an amount computed in accordance with the decision of the Board which has become final; and

(3) As to any amount collected after the period of limitation upon the beginning of distraint or a proceeding in court for collection has expired; but in any such claim for credit or refund or in any such suit for refund the decision of the Board which has become final, as to whether such period has expired before the notice of deficiency was mailed, shall be conclusive.

(d) *Overpayment found by Board.* If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, the Board shall have jurisdiction to determine the amount of such overpayment and such amount shall, when the decision of the Board has become final, be credited or refunded to the taxpayer. No such credit or refund shall be made of any portion of the tax unless the Board determines as part of its decision (1) that such portion was paid (A) within two years before the filing of the claim, the mailing of the notice of deficiency, or the execution of an agreement by both the Commissioner and the taxpayer pursuant to section 276 (b) to extend beyond the time prescribed in section 275 the time within which the Commissioner might assess the tax, whichever is earliest, or (B) within three years before the filing of the claim, the mailing of the notice of deficiency, or the execution of the agreement, whichever is earliest, if the claim was filed, the notice of deficiency mailed, or the agreement executed within three years from the time the return was filed by the taxpayer, or (C) after the execution of such an agreement and before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, or (D) after the mailing of the notice of deficiency; or (2), if such portion was not paid within the period described in clause (1), but the notice of deficiency was mailed within seven years from the time prescribed for the filing of the return, or a claim described in subsection (b) (5) was filed, that such portion does not exceed the amount of the overpayment attributable to the deductibility of items described in subsection (b) (5).

(e) *Presumption as to date of payment.* For the purposes of this section, any tax

actually deducted and withheld at the source during any calendar year under Part II of Subchapter D or under Subchapter D of Chapter 9 shall, in respect of the recipient of the income, be deemed to have been paid by him not earlier than the fifteenth day of the third month following the close of his taxable year with respect to which such tax is allowable as a credit under section 35 or section 466 (e). For the purposes of this section, any amount paid as estimated tax for any taxable year shall be deemed to have been paid not earlier than the fifteenth day of the third month following the close of such taxable year.

(f) *Tax withheld at source.* For refund or credit in case of withholding agent, see section 143 (f). For refund or credit in case of employer required to deduct and withhold tax on wages, see section 1622 (f). [NOTE: Under sec. 2 (d), Current Tax Payment Act 1943, the amendment of section 322 (f) by sec. 2 (b) is effective July 1, 1943. Prior to such amendment section 322 (f) read as follows: "For refund or credit in case of withholding agent, see sections 143 (f) and 466 (f)."]

§ 29.322–1 *Authority for abatement, credit, and refund of tax.* Authority for the credit and refund of any overpayment of any income tax imposed by chapter 1 is contained in section 322.

Section 273 (j) prohibits the filing of claims for abatement by taxpayers with respect to assessments of income tax imposed by chapter 1.

§ 29.322–2 *Credit and refund adjustments.* Overassessments and overpayments of income taxes will be adjusted by means of certificates of overassessment. Credits or refunds of overpayments on the basis of such certificates of overassessment may not be allowed or made, however, after the expiration of the statutory period of limitation properly applicable unless prior to the expiration of such period a claim therefor on Form 843 has been filed by the taxpayer. The claim, together with appropriate supporting evidence, must be filed in the office of the collector for the district in which the tax was paid. Where an amount of tax in excess of that properly due has been paid by a withholding agent, the credit or refund for such excess amount shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent. (See section 143 (f).) As to interest in case of credits or refunds, see section 3771, and section 177, United States Judicial Code, as amended by section 615 of the Revenue Act of 1928 and section 808 of the Revenue Act of 1936.

§ 29.322–3 *Claims for refund by taxpayers.* Claims by the taxpayer for the refunding of taxes, interest, penalties, and additions to tax erroneously or illegally collected shall be made on Form 843, and should be filed with the collector of internal revenue. A separate claim on such form shall be made for each taxable year or period.

The claim must set forth in detail and under oath each ground upon which a refund is claimed, and facts sufficient to apprise the Commissioner of the exact basis thereof. No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed prior to the expiration of such period. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund. With respect to limitations upon the refunding or crediting of taxes, see § 29.322–7.

If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter a refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made in the claim showing that the return was filed by the fiduciary and that the latter is still acting. In such cases, if a refund or interest is to be paid, letters testamentary, letters of administration, or other evidence may be required, but should be submitted only upon the receipt of a specific request therefor. If a claim is filed by a fiduciary other than the one by whom the return was filed, the necessary documentary evidence should accompany the claim. The affidavit may be made by the agent of the person assessed, but in such a case a power of attorney must accompany the claim.

Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and may be sent to such persons in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks. The Commissioner may, however, send any such check direct to the claimant. In this connection, see section 3477 of the Revised Statutes.

The Commissioner has no authority to refund on equitable grounds penalties or other amounts legally collected. As to claims for refund of sums recovered by suit, see §§ 29.322–4 to 29.322–6, inclusive.

§ 29.322–4 *Claim for payment of judgment obtained against collector.* (a) A claim for the amount of a judgment against a collector of internal revenue for the recovery of taxes, penalties, or other sums should be made under oath, on Form 843, and filed directly with the Commissioner of Internal Revenue, Washington, D. C. Two certified copies of the final judgment and a certificate of probable cause should be attached to the claim. If the payment of court costs is claimed, an itemized bill of the court costs paid, receipted by the clerk of the court, should also accompany the claim. With respect to the certificate of probable cause, section 989 of the Revised Statutes provides:

SEC. 989. When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury.

If the case was appealed, two certified copies of the mandate of the appellate court should also be attached to the claim. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

(b) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name, accompanied by two certified copies of the final judgment, and an itemized bill of the court costs paid. A certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, should accompany the claim. (See further § 29.322–3.)

§ 29.322–5 *Claim for payment of judgment obtained in United States district court against the United States.* A claim for the payment of a judgment rendered by a United States district court against the United States representing taxes, penalties, or other sums should be made under oath, on Form 843, in duplicate, and filed directly with the Commissioner of Internal Revenue, Washington, D. C. Two certified copies of the final judgment should be attached to the claim. If the judgment specifically provides for the recovery of costs, an itemized bill of such court costs paid, receipted by the clerk of the court, should also accompany the claim. If the case was appealed, two certified copies of the mandate of the appellate court should also be attached to the claim. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

§ 29.322–6 *Claim for payment of judgment obtained in the Court of Claims against the United States.* A claim for the payment of a judgment rendered by the United States Court of Claims against the United States, representing taxes, penalties, or other sums should be made under oath, on Form 843, in duplicate, and filed directly with the Commissioner of Internal Revenue, Washington, D. C., accompanied by a certificate of judgment issued by the clerk of the court and two copies of the printed opinion of the court, if an opinion was rendered. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified

copies of such waiver are furnished to the Commissioner.

§ 29.322–7 *Limitations upon the crediting and refunding of taxes paid*—(a) *General rule.* Unless a claim for credit or refund of an overpayment is filed within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, the Commissioner is prohibited from allowing or making a credit or refund of income tax imposed by chapter 1 for such year after both periods have expired. If no return is filed by the taxpayer, the Commissioner is prohibited from allowing or making a credit or refund of such tax after two years from the time the tax was paid unless before the expiration of such 2-year period a claim therefor is filed. The amount of the credit or refund in any case shall not exceed the portion of the tax paid:

(1) If a return was filed by the taxpayer, and the claim was filed within three years from the time the return was filed, during the three years immediately preceding the filing of the claim.

(2) If a claim was filed, and (i) no return was filed, or (ii) if the claim was not filed within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the filing of the claim.

(3) If no claim was filed and the allowance of credit or refund is made within three years from the time the return was filed by the taxpayer, during the three years immediately preceding the allowance of the credit or refund.

(4) If no claim was filed, and (i) no return was filed or (ii) the allowance of the credit or refund is not made within three years from the time the return was filed by the taxpayer, during the two years immediately preceding the allowance of the credit or refund.

For the purposes of this section, a return filed before the last day prescribed by law for the filing thereof, or an advance payment of any portion of the tax made prior to such date, shall be considered as filed or made on the last day prescribed by law for the filing of such return or the payment of such tax. If the taxpayer elected to pay the tax in installments, such an advance payment shall be considered as made on the last day prescribed for the payment of the first installment, but in all cases the last day prescribed by law for filing the return or paying the tax shall be determined without regard to any extension of time granted the taxpayer for filing the return or paying the tax. The provisions of this subsection are subject to the exceptions provided in paragraphs (b), (c), and (d) of this section.

(b) *Limitations in case waiver executed.* If the Commissioner and the taxpayer, within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, whichever period expires the later, have agreed in writing under the provisions of section 276 (b) to extend beyond the period prescribed in section 275 the time within which the Commissioner may make an assessment, then the period within which a claim for credit or refund may be filed, or a credit or refund may be allowed or made if no claim is filed, is the period within which the Commissioner may make an assessment pursuant to such agrement or any extension thereof, and for six months thereafter. The amount of the credit or refund in such case shall not, however, exceed the sum of:

(1) The portion of the tax paid during the two years immediately preceding the execution of the agreement between the Commissioner and the taxpayer, or, if such agreement was executed within three years from the time the return was filed, during the three years immediately preceding the execution of such agreement;

(2) The portion of the tax paid after the execution of the agreement between the Commissioner and the taxpayer and before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof; and

(3) The portion of tax paid during the six months immediately following the expiration of the period within which the Commissioner might make an assessment pursuant to the agreement between the Commissioner and the taxpayer or any extension of such agreement.

If any portion of the tax is paid within six months after the expiration of the period within which the Commissioner might make an assessment pursuant to an agreement between the Commissioner and the taxpayer or any extension thereof, and if credit or refund is allowed or made after such payment and before the end of such 6-month period, or if claim for credit or refund is filed after such payment and before the end of such 6-month period, then the limitations on such credit or refund are those set forth in the preceding provisions of this subsection.

Credit or refund may be allowed or made more than six months after the expiration of the period within which the Commissioner might make an assessment pursuant to an agreement between the Commissioner and the taxpayer or any extension thereof (in cases other than those described in the immediately preceding paragraph) only if such credit or refund is allowed or made within six months after the tax was paid or if claim for such credit or refund is filed within six months after such payment. In such case, the amount of the credit or refund shall not exceed the portion of the tax paid during the six months immediately preceding the filing of the claim or, if no claim was filed, the amount of the credit or refund shall not exceed the portion of the tax paid during the six months immediately preceding the allowance of the credit or refund. The 2-year period provided in section 322 (b) (1) and (2) is not applicable in any case in which the tax was paid after the execution of such an agreement.

If a claim for credit or refund is filed or if credit or refund is allowed or made before the execution of any agreement between the Commissioner and the taxpayer to extend the period within which the Commissioner might make an assessment, the limitations on such credit or refund shall be those specified in paragraph (a) of this section.

The agreement referred to in this subsection will not be considered to have been executed until the date it is signed by or for the Commissioner.

(c) *Overpayment on account of bad debts, worthless securities, etc.* If the claim for credit or refund relates to an overpayment on account of:

(1) The deductibiiity by the taxpayer, under section 23 (k) (1), section 23 (k) (4), or section 204 (c), of a debt as a debt which became worthless, or, under section 23 (g) (2) or (k) (2), of a loss from the worthlessness of a security, or

(2) The effect that the deductibility of a debt or loss described in subparagraph (1) has on the application to the taxpayer of a carry-over or of a carry-back, such as the carry-over of a capital loss provided in section 117 (e) or the carry-over or carry-back of a net operating loss provided in section 122 (b),

then in lieu of the 3-year period from the date the return was filed in which the claim may be filed or credit or refund allowed or made, as prescribed in paragraph (a) of this section, the period shall be seven years from the date prescribed by law for filing the return (determined without regard to any extension of time for filing such return) for the taxable year for which the claim is made or the credit or refund allowed or made. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in paragraph (a) or (b) of this section, whichever is applicable, to the extent of the amount of the overpayment attributable to the deductibility of items described in this paragraph. Such a credit or refund can not exceed the sum of the following:

(i) The portion, if any, of the tax paid within the period provided in paragraph (a) or (b) of this section, whichever is applicable, and

(ii) The amount of overpayment due to the deductibility of items described in this paragraph.

The portion of an overpayment due to items described in this paragraph shall be determined by treating the proper deduction of such items as the first adjustment to be made in computing such overpayment.

If claim for credit or refund is not filed and if credit or refund is not allowed or made within the 7-year period described in the preceding paragraph, then credit or refund may be allowed or made only if claim therefor is filed within, or if such credit or refund is allowed or made within, any period prescribed in paragraph (a) or (b) of this section, whichever is applicable, subject to the provisions of such paragraph (a) or (b), limiting the amount of credit or refund in the case of a claim filed or, if no claim was filed, in the case of refund or credit allowed or made within such applicable period.

The provisions of section 322 (b) (5) do not apply to an overpayment due to the deductibility of a debt that became partially worthless during the taxable

year, but only to an overpayment due to the deductibility of a debt which became entirely worthless during such year

The provisions of this paragraph with regard to an overpayment caused by the deductibility of a bad debt under section 23 (k) (1), section 23 (k) (4), or section 204 (c) or of a loss from the worthlessness of a security under section 23 (g) (2) or (k) (2) are likewise applicable to an overpayment caused by the effect that the deductibility of such a bad debt or loss has on the application to the taxpayer of a carry-over or of a carry-back.

For the limitation on the allowance of interest for an overpayment where credit or refund is subject to the provisions of section 322 (b) (5), see section 3771 (d).

(d) *Overpayment determined by The Tax Court.* In any case where a person having a right to file a petition with The Tax Court of the United States with respect to a deficiency in income tax imposed by chapter 1 filed such petition within the prescribed time, no credit or refund of the tax for the year to which the deficiency relates shall be allowed or made, and no suit for the recovery of any part of such tax shall be instituted by the taxpayer, subject to the following exceptions:

(1) If The Tax Court finds that there is no deficiency but that the person has overpaid his tax for the year to which the notice of deficiency relates, and the decision of The Tax Court as to the amount overpaid has become final (see section 1140), the overpayment shall be credited or refunded, but no such credit or refund shall be made of any portion of the tax unless The Tax Court determines as part of its decision:

(i) That such portion was paid:

(*a*) Within two years immediately preceding the filing of a claim for credit or refund thereof, the mailing of the notice of deficiency, or the execution of an agreement by both the Commissioner and the taxpayer pursuant to section 276 (b) to extend beyond the time prescribed in section 275 the time within which the Commissioner might assess the tax, whichever event occurs first in point of time, or

(*b*) Within three years immediately preceding the filing of the claim, the mailing of the notice of deficiency, or the execution of the agreement, whichever event occurs first in point of time, if the claim was filed, the notice of deficiency mailed, or the agreement executed within three years from the time the return was filed by the taxpayer, or

(*c*) After the execution of such an agreement and before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, or

(*d*) After the mailing of the notice of deficiency; or

(ii) If such portion of the tax was not paid within the period described in (i) of this subparagraph, but the notice of deficiency was mailed within seven years from the time prescribed for the filing of the return (determined without regard to any extension of time for filing such return), or a claim of the type described in paragraph (c) of this section was filed, that such portion of the tax does not exceed the amount of the overpayment attributable to the deductibility of items described in such paragraph (c). The amount of the overpayment attributable to the deductibility of items described in paragraph (c) of this section shall be determined under the provisions of that paragraph. For the limitation on the allowance of interest for such portion of the overpayment, see section 3771 (d).

(2) In the case of a jeopardy assessment made under section 273, if the amount which should have been assessed as determined by a decision of The Tax Court which has become final is less than the amount already collected, the excess payment shall be credited or refunded subject to a determination being made by The Tax Court with respect to the time of payment as stated in paragraph (d) (1) of this section.

(3) If the amount of the deficiency determined by The Tax Court (in a case where collection has not been stayed by the filing of a bond) is disallowed in whole or in part by the reviewing court, then the overpayment resulting from such disallowance shall be credited or refunded without the making of claim therefor subject to a determination being made by The Tax Court with respect to the time of payment as stated in paragraph (d) (1) of this section. (See section 1146.)

(4) Where the amount collected is in excess of the amount computed in accordance with the decision of The Tax Court which has become final, the excess payment shall be credited or refunded within the period of limitation provided in section 322 (b).

(5) Where an amount is collected after the statutory period of limitation upon the beginning of distraint or a proceeding in court for collection has expired (see § 29.275–2), the taxpayer may file a claim for refund of the amount so collected within the period of limitation provided in section 322 (b). In any such case, the decision of The Tax Court as to whether the statutory period upon collection of the tax expired before notice of the deficiency was mailed shall, when the decision becomes final, be conclusive.

§ 29.322–8 *Crediting of accounts of collectors in cases of assessments against several persons covering same liability.* If assessments have been made against several persons covering the same tax liability, and payment of such liability by one or more of such persons has been duly certified to the Commissioner, the Commissioner, for the purpose of temporarily relieving the collector from liability under section 3950, may authorize him to take credit temporarily with respect to the assessments not specifically paid. Such action, however, shall not constitute an abatement and shall not discharge the liability of the persons concerned.

FOREIGN PERSONAL HOLDING COMPANIES

SEC. 331. DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY.

(a) *General rule.* For the purposes of this chapter the term "foreign personal holding company" means any foreign corporation if—

(1) *Gross income requirement.* At least 60 per centum of its gross income (as defined in section 334 (a)) for the taxable year is foreign personal holding company income as defined in section 332; but if the corporation is a foreign personal holding company with respect to any taxable year ending after August 26, 1937, then, for each subsequent taxable year, the minimum percentage shall be 50 per centum in lieu of 60 per centum, until a taxable year during the whole of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 50 per centum of the gross income is foreign personal holding company income. For the purposes of this paragraph there shall be included in the gross income the amount includible therein as a dividend by reason of the application of section 334 (c) (2); and

(2) *Stock ownership requirement.* At any time during the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States, hereinafter called "United States group."

(b) *Exceptions.* The term "foreign personal holding company" does not include a corporation exempt from taxation under section 101.

§ 29.331–1 *Definition of foreign personal holding company.* A foreign personal holding company is any foreign corporation (other than a corporation exempt from taxation under section 101) which for the taxable year meets (a) the gross income requirement specified in § 29.331–2, and (b) the stock ownership requirement specified in § 29.331–3. Both requirements must be satisfied and both must be met with respect to each taxable year.

A foreign corporation which comes within the classification of a foreign personal holding company is not subject to taxation either under section 102 or section 500. The fact that a foreign corporation is a foreign personal holding company does not relieve the corporation from liability for the taxes imposed generally under section 231 upon foreign corporations, since such taxes apply regardless of the classification of the foreign corporation as a foreign personal holding company.

§ 29.331–2 *Gross income requirement.* To meet the gross income requirement, it is necessary that either of the following percentages of gross income of the corporation for the taxable year (including the additions to gross income provided in section 334 (b) as required by section 334 (c) (2)) be foreign personal holding company income as defined in section 332:

(a) 60 percent or more; or

(b) 50 percent or more if the foreign corporation has been classified as a foreign personal holding company for any taxable year ending after August 26, 1937, unless:

(1) A taxable year has intervened since the last taxable year for which it was so classified, during no part of which

the stock ownership requirement specified in section 331 (a) (2) exists; or

(2) Three consecutive years have intervened since the last taxable year for which it was so classified, during each of which its foreign personal holding company income was less than 50 percent of its gross income.

In determining whether the foreign personal holding company income is equal to the required percentage of the total gross income, the determination must not be made upon the basis of gross receipts, since gross income is not synonymous with gross receipts. For a further discussion of what constitutes "gross income," see section 22 (a) and §§ 29.22 (a)–1 to 29.22 (a)–20, inclusive.

§ 29.331–3 *Stock ownership requirement.* To meet the stock ownership requirement, it is necessary that at some time in the taxable year more than 50 percent in value of the outstanding stock of the foreign corporation be owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States, hereinafter referred to as "United States group." For such purpose, the ownership of the stock must be determined as provided in section 333 and §§ 29.333 (a)–1 to 29.333 (a)–7, inclusive, and § 29.333 (b)–1.

In the event of any change in the stock outstanding during the taxable year, whether in the number of shares or classes of stock, or whether in the ownership thereof, the conditions existing immediately prior and subsequent to each change must be taken into consideration, since a corporation comes within the classification if the statutory conditions with respect to stock ownership are present at any time during the taxable year.

In determining whether the statutory conditions with respect to stock ownership are present at any time during the taxable year, the phrase "in value" shall, in the light of all the circumstances, be deemed the value of the corporate stock outstanding at such time (not including treasury stock). This value may be determined upon the basis of the company's net worth, earning and dividend paying capacity, appreciation of assets, together with such other factors as have a bearing upon the value of the stock. If the value of the stock which is used is greatly at variance with that reflected by the corporate books, the evidence of such value should be filed with the return. In any case where there are two or more classes of stock outstanding, the total value of all the stock should be allocated among the different classes according to the relative value of each class therein.

SEC. 332. FOREIGN PERSONAL HOLDING COMPANY INCOME.

For the purposes of this chapter the term "foreign personal holding company income" means the portion, of the gross income determined for the purposes of section 331 (a) (1), which consists of:

(a) Dividends, interest, royalties, annuities.

(b) *Stock and securities transactions.* Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

(c) *Commodities transactions.* Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This subsection shall not apply to gains by a producer, processor, merchant, or handler of the commodity which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others.

(d) *Estates and trusts.* Amounts includible in computing the net income of the corporation under Supplement E; and gains from the sale or other disposition of any interest in an estate or trust.

(e) *Personal service contracts.* (1) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and (2) amounts received from the sale or other disposition of such a contract. This subsection shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(f) *Use of corporation property by shareholder.* Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement.

(g) *Rents.* Rents, unless constituting 50 per centum or more of the gross income. For the purposes of this subsection the term "rents" means compensation, however designated, for the use of, or right to use, property; but does not include amounts constituting foreign personal holding company income under subsection (f).

§ 29.332–1 *Foreign personal holding company income.* For the purposes of Supplement P (sections 331 to 340, inclusive) and these regulations the term "foreign personal holding company income" means the portion of the gross income determined for the purposes of section 331 (a) (1) and § 29.331–2 which consists of the following:

(a) *Dividends.* The term "dividends" includes dividends as defined in section 115 (a) and amounts required to be included in gross income under section 334 (b). See § 29.115–1.

(b) *Interest.* The term "interest" means any amounts, includible in gross income, received for the use of money loaned.

(c) *Royalties.* The term "royalties" includes amounts received for the privilege of using patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property. It does not include rents, or overriding royalties received by an operating company. As used in this paragraph the term "overriding royalties" means amounts received from the sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.

(d) *Annuities.* The term "annuities" includes annuities only to the extent includible in the computation of gross income. (See section 22 (b) (2).)

(e) *Gains from the sale or exchange of stock or securities.* The term "gains from the sale or exchange of stock or securities" as used in section 332 (b) applies to all gains (including gains from liquidating dividends and other distributions from capital) from the sale or exchange of stock or securities includible in gross income. The term "stock or securities" as used in section 332 (b) includes shares or certificates of stock, or interest in any corporation (including any joint-stock company, insurance company, association, or other organization classified as a corporation by the Internal Revenue Code), certificates of interest or participation in any profit-sharing agreement, or in any oil, gas, or other mineral royalty, or lease, collateral trust certificates, voting trust certificates, stock rights or warrants, bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, and obligations issued by or on behalf of a Government, State, Territory, or political subdivision thereof. In the case of "regular dealers in stock or securities" the term does not include gains derived from the sale or exchange of stock or securities made in the normal course of business. The term "regular dealers in stock or securities" as used in section 332 (b) means corporations with an established place of business regularly engaged in the purchase of stock or securities and their resale to customers, but such corporations are not dealers with respect to stock or securities held for speculation or investment.

(f) *Gains from futures transactions in commodities.* Gains from futures transactions in commodities include gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange, but do not include gains from cash transactions or gains by a producer, processor, merchant, or handler of the commodity, which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others. In general, foreign personal holding company income includes gains on futures contracts which are speculative. Futures contracts representing true hedges against price fluctuations in spot goods are not speculative transactions, though not concurrent with spot transactions. Futures contracts which are not hedges against spot transactions are speculative unless they are hedges against concurrent futures or forward sales or purchases.

(g) *Income from estates and trusts.* The income from estates and trusts which is to be included in foreign personal holding company income consists of the income from estates and trusts which is required to be included in the

gross income of the corporation under sections 161 to 169, inclusive, together with the gains derived by the corporation from the sale or other disposition of any interest in an estate or trust.

(h) *Amounts received under personal service contracts.* Amounts includible in foreign personal holding company income as amounts received under personal service contracts consist of amounts received pursuant to a contract under which the corporation is to furnish personal services, and amounts received from a sale or other disposition of such a contract, if:

(1) Some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description in the contract); and

(2) At some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description), as the one to perform such services. For this purpose the stock ownership must be determined as provided in section 333 and §§ 29.333 (a)–1 to 29.333 (a)–7, inclusive, and § 29.333 (b)–1.

The application of section 332 (e) may be illustrated by the following examples:

Example (1). A, whose profession is that of an actor, owns all of the outstanding capital stock of the M Corporation, a foreign corporation. The M Corporation enacted into a contract with A under which A was to perform personal services for the person or persons which the M Corporation might designate, in consideration of which A was to receive $10,000 a year from the M Corporation. The M Corporation entered into a contract with the O Corporation in which A was designated to perform personal services for the O Corporation, in consideration of which the O Corporation was to pay the M Corporation $500,000 a year. The $500,000 received by the M Corporation from the O Corporation constitutes foreign personal holding company income.

Example (2). The N Corporation, a foreign corporation, the entire outstanding capital stock of which is owned by four individuals, is engaged in engineering. The N Corporation entered into a contract with the O Corporation to perform engineering services for the O Corporation, in consideration of which the O Corporation was to pay the N Corporation $50,000. The individual who was to perform the services was not designated (by name or by description) in the contract and no one but the N Corporation had the right to designate (by name or by description) such individual. The $50,000 received by the N Corporation from the O Corporation does not constitute foreign personal holding company income.

(i) *Compensation for use of property.* The compensation for the use of, or the right to use, property of the corporation which is to be included in foreign personal holding company income consists of amounts received as compensation (however designated and from whomsoever received) for the use of, or the right to use, property of the corporation in any case in which, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property, whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. The property may consist of a yacht, a city residence, a country house, or any other kind of property. See sections 331 (a) (2) and 333 and §§ 29.333 (a)–1 to 29.333 (a)–7, inclusive, and § 29.333 (b)–1.

(j) *Rents.* The rents which are to be included in foreign personal holding company income consist of compensation, however designated, including charter fees, etc., for the use of, or the right to use, real property, or any other kind of property, but do not include amounts constituting foreign personal holding company income under section 332 (f) and paragraph (i) of this section. However, rents do not constitute foreign personal holding company income if constituting 50 percent or more of the gross income of the corporation.

SEC. 333. STOCK OWNERSHIP.

(a) *Constructive ownership.* For the purpose of determining whether a foreign corporation is a foreign personal holding company, insofar as such determination is based on stock ownership under section 331 (a) (2), section 332 (e), or section 332 (f)—

(1) *Stock not owned by individual.* Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) *Family and partnership ownership.* An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of this paragraph the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(3) *Options.* If any person has an option to acquire stock such stock shall be considered as owned by such person. For the purposes of this paragraph an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) *Application of family-partnership and option rules.* Paragraphs (2) and (3) shall be applied—

(A) For the purposes of the stock ownership requirement provided in section 331 (a) (2), if, but only if, the effect is to make the corporation a foreign personal holding company;

(B) For the purposes of section 332 (e) (relating to personal service contracts), or of section 332 (f) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such subsection as foreign personal holding company income.

(5) *Constructive ownership as actual ownership.* Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for the purpose of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for the purpose of again applying such paragraph in order to make another the constructive owner of such stock.

(6) *Option rule in lieu of family and partnership rule.* If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

§ 29.333 (a)–1 *Stock ownership.* For the purpose of determining whether:

(a) A foreign corporation is a foreign personal holding company, in so far as such determination is based on the stock ownership requirements specified in section 331 (a) (2) and § 29.331–3, or

(b) Amounts received under a personal service contract or from the sale of such a contract constitute foreign personal holding company income in so far as such determination is based on the stock ownership requirement specified in section 332 (e) and paragraph (h) of § 29.332–1, or

(c) Compensation for the use of property constitutes foreign personal holding company income in so far as such determination is based on the stock ownership requirement specified in section 332 (f) and paragraph (i) of § 29.332–1,

stock owned by an individual includes stock constructively owned by him as provided in section 333. For such purpose constructive ownership of stock shall be determined and applied in accordance with the rules provided in section 333 and §§ 29.333 (a)–2 to 29.333 (a)–7, inclusive, and § 29.333 (b)–1. All forms and classes of stock, however denominated, which represent the interests of shareholders, members, or beneficiaries in the corporation shall be taken into consideration.

§ 29.333 (a)–2 *Stock not owned by individual.* In determining the ownership of stock for any of the purposes set forth in § 29.333 (a)–1, stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries. For example, if A and B, two individuals, are the exclusive and equal beneficiaries of a trust or estate, and if such trust or estate owns the entire capital stock of the M Corporation, and if the M Corporation in turn owns the entire capital stock of the N Corporation, then the stock of both the M Corporation and the N Corporation shall be consired as being owned equally by A and B as the individuals owning the beneficial interest therein. See also § 29.333 (a)–6.

§ 29.333 (a)–3 *Family and partnership ownership.* In determining the ownership of stock for any of the purposes set forth in § 29.333 (a)–1, an individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of such determination the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

The application of the family and partnership rule in determining the ownership of stock for the purpose set forth in (a) of § 29.333 (a)–1 is illustrated by the following example:

Example. The M Corporation at some time during the taxable year had 1,800 shares of outstanding stock, 450 of which were held by various individuals having no relationship to one another and none of whom were partners, and the remaining 1,350 were held by 51 shareholders as follows:

Relationships	Shares	Shares	Shares	Shares	Shares
An individual	A 100	B 20	C 20	D 20	E 20
His father	AF 10	BF 10	CF 10	DF 10	EF 10
His wife	AW 10	BW 40	CW 40	DW 40	EW 40
His brother	AB 10	BB 10	CB 10	DB 10	EB 10
His son	AS 10	BS 40	CS 40	DS 40	ES 40
His daughter by former marriage (son's half-sister)	ASHS 10	BSHS 40	CSHS 40	DSHS 40	ESHS 40
His brother's wife	ABW 10	BBW 10	CBW 10	DBW 160	EBW 10
His wife's father	AWF 10	BWF 10	CWF 110	DWF 10	EWF 10
His wife's brother	AWB 10	BWB 10	CWB 10	DWB 10	EWB 10
His wife's brother's wife	AWBW 10	BWBW 10	CWBW 10	DWBW 10	EWBW 110
Individual's partner	AP 10				

By applying the statutory rule provided in section 333 (a) (2) five individuals own more than 50 percent of the outstanding stock as follows:

A (including AF, AW, AB, AS, ASHS, AP)	160
B (including BF, BW, BB, BS, BSHS)	160
CW (including C, CS, CWF, CWB)	220
DB (including D, DF, DBW)	200
EWB (including EW, EWF, EWBW)	170
Total, or more than 50 percent	910

Individual A represents the obvious case where the head of the family owns the bulk of the family stock and naturally is the head of the group. A's partner owns 10 shares of the stock. Individual B represents the case where he is still head of the group because of the ownership of stock by his immediate family. Individuals C and D represent cases where the individuals fall in groups headed in C's case by his wife and in D's case by his brother because of the preponderance of holdings on the part of relatives by marriage. Individual E represents the case where the preponderant holdings of others eliminate that individual from the group.

The method of applying the family and partnership rule as illustrated in the foregoing example also applies in determining the ownership of stock for the purposes stated in (b) and (c) of § 29.333 (a)–1.

§ 29.333 (a)–4 *Options.* In determining the ownership of stock for any of the purposes set forth in § 29.333 (a)–1, if any person has an option to acquire stock, such stock may be considered as owned by such person. The term "option" as used in this section includes an option to acquire such an option and each one of a series of such options, so that the person who has an option on an option to acquire stock may be considered as the owner of the stock.

§ 29.333 (a)–5 *Application of family-partnership and option rules.* The family and partnership rule provided in section 333 (a) (2) and § 29.333 (a)–3 and the option rule provided in section 333 (a) (3) and § 29.333 (a)–4 shall be applied:

(a) For the purpose stated in paragraph (a) of § 29.333 (a)–1, if, but only if, the effect of such application is to make the foreign corporation a foreign personal holding company, or

(b) For the purpose stated in paragraph (b) of § 29.333 (a)–1, if, but only if, the effect of such application is to make the amounts received under a personal service contract or from the sale of such a contract foreign personal holding company income, or

(c) For the purpose stated in paragraph (c) of § 29.333 (a)–1, if, but only if, the effect of such application is to make the compensation for the use of property foreign personal holding company income.

The family and partnership rule and the option rule must be applied independently for each of the purposes stated in § 29.333 (a)–1.

§ 29.333 (a)–6 *Constructive ownership as actual ownership.* In determining the ownership of stock for any of the purposes set forth in § 29.333 (a)–1:

(a) Stock constructively owned by a person by reason of the application of the rule provided in section 333 (a) (1) relating to stock not owned by an individual (see § 29.333 (a)–2) shall be considered as actually owned by such person for the purpose of again applying such rule or of applying the family and partnership rule provided in section 333 (a) (2) (see § 29.333 (a)–3) in order to make another person the constructive owner of such stock, and

(b) Stock constructively owned by a person by reason of the application of the option rule provided in section 333 (a) (3) (see § 29.333 (a)–4) shall be considered as actually owned by such person for the purpose of applying either the rule provided in section 333 (a) (1), relating to stock not owned by an individual, or the family and partnership rule provided in section 333 (a) (2) in order to make another person the constructive owner of such stock, but

(c) Stock constructively owned by an individual by reason of the application of the family and partnership rule provided in section 333 (a) (2) shall not be considered as actually owned by such individual for the purpose of again applying such rule in order to make another individual the constructive owner of such stock.

The application of this section may be illustrated by the following examples:

Example (1). A is a United States citizen, whose wife, AW, owns all of the stock of the M Corporation, which in turn owns all the stock of the O Corporation. The O Corporation in turn owns all the stock in the P Corporation.

Under the rule provided in section 333 (a) (1), relating to stock not owned by an individual, the stock in the P Corporation owned by the O Corporation is considered to be owned constructively by the M Corporation, the sole shareholder of the O Corporation. Such constructive ownership of the stock by the M Corporation is considered as actual ownership for the purpose of again applying such rule in order to make AW, the sole shareholder of the M Corporation, the constructive owner of the stock of the P Corporation. Similarly, the constructive ownership of the stock by AW is considered as actual ownership for the purpose of applying the family and partnership rule provided in section 333 (a) (2) in order to make A the constructive owner of the stock of the P Corporation, if such application is necessary for any of the purposes set forth in § 29.333 (a)–1. But the stock thus constructively owned by A may not be considered as actual ownership for the purpose of again applying the family and partnership rule in order to make another member of A's family, for example A's father, the constructive owner of the stock of the P Corporation.

Example (2). B is a United States citizen who owns all the stock of the R Corporation which has an option to acquire all the stock of the S Corporation, a foreign corporation, owned by C, an individual, who is not related to B.

Under the option rule provided in section 333 (a) (3) the R Corporation may be considered as owning constructively the stock of the S Corporation owned by C. Such constructive ownership of the stock by the R Corporation is considered as actual ownership for the purpose of applying the rule provided in section 333 (a) (1), relating to stock not owned by an individual, in order to make B, the sole shareholder of the R Corporation, the constructive owner of the stock of the S Corporation. The stock thus constructively owned by B by reason of the application of the rule provided in section 333 (a) (1) likewise is considered as actual ownership for the purpose, if necessary, of applying the family and partnership rule provided in section 333 (a) (2), in order to make another member of B's family, for example, B's wife, BW, the constructive owner of the stock of the S Corporation. However, the family and partnership rule could not again be applied so as to make still another individual the constructive owner of the stock of the S Corporation, that is, the stock constructively owned by BW could not be considered as actually owned by her in order to make BW's father the constructive owner of such stock by a second application of the family and partnership rule.

§ 29.333 (a)–7 *Option rule in lieu of family and partnership rule.* If, in determining the ownership of stock for any of the purposes set forth in § 29.333 (a)–1, stock may be considered as constructively owned by an individual by an application of both the family-partnership rule provided in section 333 (a) (2) (see § 29.333 (a)–3) and the option rule provided in section 333 (a) (3) (see § 29.333 (a)–4) such stock shall be considered as owned constructively by the individual by reason of the application of the option rule.

The application of this section may be illustrated by the following example:

Example. Two brothers, A and B, each own 10 percent of the stock of the M Corporation, a foreign corporation, and A's wife, AW, also owns 10 percent of the stock of such corporation. AW's husband, A, has an option to acquire the stock owned by her at any time. It becomes necessary, for one of the purposes stated in § 29.333 (a)–1, to determine the stock ownership of B in the M Corporation.

If the family and partnership rule were the only rule that applied in the case, B would be considered, under that rule, as owning 20 percent of the stock of the M Corporation, namely, his own stock plus the stock owned by his brother. In that event, B could not be considered as owning the stock held by AW since (1) AW is not a member of B's family and (2) the constructive ownership of such stock by A through the application of the family and partnership rule in his case is not considered as actual ownership so as to make B the constructive owner by a second application of the same rule with respect to the ownership of the stock. (See § 29.333 (a)–6.)

However, there is more than the family and partnership rule involved in this ex-

ample. As the holder of an option upon the stock, A may be considered the constructive owner of his wife's stock by the application of the option rule and without reference to the family relationship between A and AW. If A is considered as owning the stock of his wife by application of the option rule, then under § 29.333 (a)–6, such constructive ownership by A is regarded as actual ownership for the purpose of applying the family and partnership rule so as to make another member of A's family, for example, B, the constructive owner of the stock. Hence, since A may be considered as owning his wife's stock by applying both the family-partnership rule and the option rule, the provisions of section 333 (a) (6) apply and accordingly A must be considered the constructive owner of his wife's stock under the option rule rather than the family-partnership rule. B thus becomes the constructive owner of 30 percent of the stock of the M Corporation, namely, his own 10 percent, A's 10 percent, and AW's 10 percent constructively owned by A as the holder of an option on the stock.

[SEC. 333. STOCK OWNERSHIP.]

(b) *Convertible securities.* Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

(1) For the purpose of the stock ownership requirement provided in section 331 (a) (2), but only if the effect of the inclusion of all such securities is to make the corporation a foreign personal holding company;

(2) For the purpose of section 332 (e) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such subsection as foreign personal holding company income; and

(3) For the purpose of section 332 (f) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such subsection as foreign personal holding company income.

The requirements in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included.

§ 29.333 (b)–1 *Convertible securities.* Under section 333 (b), outstanding securities of a foreign corporation, such as bonds, debentures, or other corporate obligations, convertible into stock of the corporation (whether or not convertible during the taxable year) shall be considered as outstanding stock of the corporation for the purpose of the stock ownership requirement provided in section 331 (a) (2), but only if the effect of such consideration is to make the corporation a foreign personal holding company. Such convertible securities shall be considered as outstanding stock for the purpose of section 332 (e), relating to amounts received under personal service contracts, or of section 332 (f), relating to compensation for the use of property, but only if the effect of such consideration is to make the amounts therein referred to includible under such sections as foreign personal holding company income. The consideration of convertible securities as outstanding stock is subject to the exception that, if some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be considered as outstanding stock although the others are not so considered, but no convertible securities shall be considered as outstanding stock unless all outstanding securities having a prior conversion date are also so considered. For example, if outstanding securities are convertible in 1942, 1943, and 1944, those convertible in 1942 can be properly considered as outstanding stock without so considering those convertible in 1943 or 1944, and those convertible in 1942 and 1943 can be properly considered as outstanding stock without so considering those convertible in 1944. However, the securities convertible in 1943 could not be properly considered as outstanding stock without so considering those convertible in 1942 and the securities convertible in 1944 could not be properly considered as outstanding stock without so considering those convertible in 1942 and 1943.

SEC. 334. GROSS INCOME OF FOREIGN PERSONAL HOLDING COMPANIES.

(a) *General rule.* As used in this Supplement with respect to a foreign corporation the term "gross income" means gross income computed (without regard to the provisions of Supplement I) as if the foreign corporation were a domestic corporation.

(b) *Additions to gross income.* In the case of a foreign personal holding company (whether or not a United States group, as defined in section 331 (a) (2), existed with respect to such company on the last day of its taxable year) which was a shareholder in another foreign personal holding company on the day in the taxable year (whether beginning before, on, or after January 1, 1939) of the second company which was last day on which a United States group existed with respect to the second company, there shall be included, as a dividend, in the gross income of the first company, for the taxable year in which or with which the taxable year of the second company ends, the amount the first company would have received as a dividend if on such last day there had been distributed by the second company, and received by the shareholders, an amount which bears the same ratio to the undistributed Supplement P net income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(c) *Application of subsection (b).* The rule provided in subsection (b)—

(1) shall be applied in the case of a foreign personal holding company for the purpose of determining its undistributed Supplement P net income which, or a part of which, is to be included in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies;

(2) shall be applied in the case of every foreign corporation with respect to which a United States group exists on some day of its taxable year, for the purpose of determining whether such corporation meets the gross income requirements of section 331 (a) (1).

§ 29.334–1 *Gross income in general for purposes of Supplement P.* For all purposes of Supplement P (sections 331 to 340, inclusive) and the regulations pertaining thereto, the gross income of a foreign corporation shall be computed as if the corporation were a domestic corporation and without regard to the provisions of Supplement I (sections 231 to 238, inclusive) and the regulations pertaining thereto, relating to the taxation of foreign corporations generally. Hence, for such purposes, the gross income includes income from all sources, whether within or without the United States, which is not excluded from gross income by section 22 (b) and the regulations pertaining to that section. The gross income thus includes the interest on bonds, notes, and certificates of indebtedness of the United States, even though owned beneficially by a foreign corporation not engaged in trade or business in the United States, and even though such interest otherwise would come within the exemption provided for in section 3 of the Fourth Liberty Bond Act of July 9, 1918, as amended by section 4 of the Victory Liberty Loan Act of March 3, 1919.

§ 29.334–2 *Additions to gross income for purposes of Supplement P.* If, for any taxable year:

(a) A foreign corporation meets the stock ownership requirement specified in § 29.331–3, regardless of whatever day in its taxable year is the last day on which the required United States group exists, and

(b) Such foreign corporation is a shareholder in a foreign personal holding company on any day of a taxable year of the second company which ends with or within the taxable year of the first company and such day is the last day in the taxable year of the second company on which the United States group exists with respect to the second company,

then for the purpose of:

(c) Determining whether the first company meets the gross income requirement specified in § 29.331–2, so as to come within the classification of a foreign personal holding company, and

(d) Determining the undistributed Supplement P net income of the first company which (in the event the first company is a foreign personal holding company) is to be included, in whole or in part, in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies,

there shall be included as a dividend in the gross income of the first company for the taxable year in which or with which the taxable year of the second company ends, the amount the first company would have received as a dividend, if on the last day referred to in (b) there had been distributed by the second company, and received by the shareholders, an amount which bears the same ratio to the undistributed Supplement P net income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year. The foregoing rules apply to any chain of foreign corporations regardless of the number of corporations included in the chain.

The application of this section may be illustrated by the following examples:

Example (1) The X Corporation is a foreign corporation whose stock is owned by A, a United States citizen. The X Corporation owns the entire stock of the Y Corporation another foreign corporation. The taxable year of the X Corporation is the calendar year and the taxable year of the Y Corporation is the fiscal year ending June 30. For the fiscal year ending June 30, 1943, more than the required percentage of the Y Corporation's gross income consists of foreign personal holding company income and no part of the earnings for such year is distributed as dividends. On the basis of these facts the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1943. The X Corporation meets the stock ownership requirement and constitutes a foreign personal holding company for 1943, if it also meets the gross income requirement.

For the purpose of determining whether the X Corporation meets the gross income requirement, the entire undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1943, must be included as a dividend in the gross income of the X Corporation for 1943, since—

(a) The X Corporation was a shareholder in the Y Corporation on a day (June 30, 1943) in the taxable year of the Y Corporation ending with or within the taxable year of the X Corporation, which day was the last day in the taxable year of the Y Corporation on which the United States group required with respect to the Y Corporation existed,

(b) Such last day was also the end of the Y Corporation's taxable year so that the portion of the taxable year of the Y Corporation up to and including such last day is equal to 100 percent of the taxable year of the Y Corporation, and, therefore, the portion of the undistributed Supplement P net income of the Y Corporation includible in the gross income of its shareholders is likewise equal to 100 percent, and

(c) The X Corporation being the sole shareholder of the Y Corporation must include such portion in its gross income for 1943, the taxable year in which or with which the taxable year of the Y Corporation ends.

If (after the inclusion of the presumptive dividend in its gross income, the X Corporation is a foreign personal holding company for 1943, then the undistributed Supplement P net income of the Y Corporation must also be included as a dividend in the gross income of the X Corporation in determining its undistributed Supplement P net income which is to be included in the gross income of A, the sole shareholder in the X Corporation. On the other hand, if, after including such presumptive dividend, the X Corporation does not constitute a foreign personal holding company, the undistributed Supplement P net income of the Y Corporation is not includible in the gross income of the X Corporation.

Example (2). The X Corporation referred to in example (1) sold the stock in the Y Corporation to other interests on September 30, 1943, so that after that date no United State group existed with respect to the Y Corporation. For the fiscal year ending June 30, 1944, more than the required percentage of the gross income of the Y Corporation consists of foreign personal holding company income. The net income of the Y Corporation for such fiscal year amounts to $1,000,000, of which $900,000 is distributed in dividends after September 30, 1943. The undistributed Supplement P net income of the Y Corporation for such fiscal year amounts to $100,000. Upon the basis of these facts the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1944, since at one time in such fiscal year, or from July 1 to and including September 30, 1943, it meets the stock ownership requirement, and the gross income requirement is also satisfied.

In determining whether the X Corporation constitutes a foreign personal holding company for 1944, a portion of the undistributed Supplement P net income of the Y Corporation for the fiscal year ending June 30, 1944 (3/12 of $100,000, or $25,000), must be included as a dividend in the gross income of the X Corporation, since—

(a) The X Corporation was a shareholder in the Y Corporation on September 30, 1943, or on a day in the taxable year of the Y Corporation ending with or within the taxable year of the X Corporation which day was the last day in the Y Corporation's taxable year on which the United States group required with respect to the Y Corporation existed.

(b) The portion of the taxable year of the Y Corporation up to and including such day is three-twelfths of the entire taxable year of the Y Corporation and, therefore, the portion of the undistributed Supplement P net income of the Y Corporation includible in the gross income of its shareholders also is equal to three-twelfths, and

(c) The X Corporation, being the sole shareholder of the Y Corporation at the time the United States group with respect to the Y Corporation last existed, must include all of such portion in its gross income for 1944, the taxable year of the X Corporation in which or with which the taxable year of the Y Corporation ends.

It is to be observed that three-twelfths of the undistributed Supplement P net income of the Y Corporation for the entire taxable year and not the earnings realized by the Y Corporation up to and including September 30, 1943, the last day on which the United States group with respect to the Y Corporation existed, must be included in the gross income of the X Corporation.

Example (3). The X Corporation referred to in example (1) sold the stock in the Y Corporation to other interests on September 30, 1943, so that after that date a different United States group existed with respect to the Y Corporation. Assuming that the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1944, no part of the undistributed Supplement P net income of the Y Corporation for such fiscal year would, in this instance, be includible in the gross income of the X Corporation for the year 1944, in determining whether the X Corporation is a foreign personal holding company for that year. In such case, the undistributed Supplement P net income of the Y Corporation is includible in the gross income of the other foreign personal holding companies, if any, and of the United States shareholders who are shareholders in the Y Corporation the day after September 30, 1943, which was the last day in the taxable year of the Y Corporation on which the United States group with respect to the Y Corporation existed.

If, however, the X Corporation sells 90 percent of its stock in the Y Corporation and thus is a minority shareholder in the Y Corporation on the last day of the taxable year of the Y Corporation on which the United States group with respect to the Y Corporation exists, the portion of the undistributed Supplement P net income allocable to the minority interest of the X Corporation would be includible in the gross income of the X Corporation, even though on such last day the United States group is not the same with respect to both corporations.

Example (4). If the Y Corporation in example (1) owns all of the stock of the Z Corporation, another foreign corporation, there would be a chain of three foreign corporations. In such case, assuming that the Z Corporation is a foreign personal holding company for a taxable year ending with or within the taxable year of the Y Corporation, the undistributed Supplement P net income of the Z Corporation would be included in the gross income of the Y Corporation for the purpose of determining whether the Y Corporation comes within the classification of a foreign personal holding company. If, after the inclusion of such presumptive dividend, the Y Corporation is a foreign personal holding company, the undistributed Supplement P net income of the Z Corporation would be included in the gross income of the Y Corporation in determining the undistributed Supplement P net income of the Y Corporation which is includible in the gross income of its shareholder, the X Corporation. The same process would be repeated with respect to determining whether the X Corporation is a foreign personal holding company and in determining its undistributed Supplement P net income. If all three corporations are foreign personal holding companies, the undistributed Supplement P net income of each would, in this manner, be reflected as a dividend in the gross income of A, the ultimate beneficial shareholder of the chain.

In the event that after the inclusion of the undistributed Supplement P net income of the Z Corporation in the gross income of the Y Corporation, the Y Corporation is not a foreign personal holding company, then no part of the income of either the Z Corporation or the Y Corporation would be includible in the gross income of the X Corporation. In that event, whether the X Corporation is a foreign personal holding company, and its undistributed Supplement P net income, would be determined independently of the income of the Y Corporation and the Z Corporation.

SEC. 335. UNDISTRIBUTED SUPPLEMENT P NET INCOME.

For the purposes of this chapter the term "undistributed Supplement P net income" means the Supplement P net income (as defined in section 336) minus the amount of the basic surtax credit provided in section 27 (b) (computed without its reduction, under section 27 (b) (1), by the amount of the credit provided in section 26 (a) relating to interest on certain obligations of the United States and Government corporations).

SEC. 336. SUPPLEMENT P NET INCOME [as amended by secs. 211 (g), 212 (c), Rev. Act 1939; secs. 135 (b), 150 (h), Rev. Act 1942].

For the purposes of this chapter the term "Supplement P net income" means the net income with the following adjustments:

(a) *Additional deductions.* There shall be allowed as deductions—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

(2) In lieu of the deduction allowed by section 23 (q), contributions or gifts payment of which is made within the taxable year to or for the use of donees described in section 23 (q) for the purposes therein specified, to an amount which does not exceed 15 per centum of the company's net income, computed without the benefit of this paragraph and section 23 (q), and without the deduction of the amount disallowed under subsection (b) of this section, and without the inclusion in gross income of the amounts includible therein as dividends by reason of the application of the provisions of section 334 (b) (relating to the inclusion in the gross income of a foreign personal holding company of its distributive share of the undistributed Supplement P net income of another foreign personal holding company in which it is a shareholder).

(b) *Deductions not allowed*—(1) *Taxes and pension trusts.* The deductions provided in section 23 (d), relating to taxes of a shareholder paid by the corporation, and in section 23 (p), relating to pension trusts, shall not be allowed.

(2) *Expenses and depreciation.* The aggregate of the deductions allowed under section 23 (a), relating to expenses, and section 23 (l), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the company, shall be allowed only in an amount equal to the rent or other compensation received for the use or right to use the property, unless it is established (under regulations prescribed by the Commissioner with the approval of the Secretary) to the satisfaction of the Commissioner:

(A) That the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(B) That the property was held in the course of a business carried on bona fide for profit; and

(C) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(3) *Net loss carry-over disallowed.* The deduction for net operating losses provided in section 23 (s) shall not be allowed.

(c) *1941 capital loss carry-over denied.* The net income shall be computed without regard to section 117 (e) (2).

(d) *Income not placed on annual basis.* The net income shall be computed without regard to section 47 (c).

§ 29.336–1 *Supplement P net income.* The term "Supplement P net income" means the gross income as defined in section 334 less the deductions provided in section 23 (computed without regard to the provisions of Supplement I (sections 231 to 238, inclusive)), subject to the qualifications, limitations, and exceptions provided in section 336. In the case of a taxable year of less than 12 months on account of a change in the accounting period of the corporation, the net income as so computed is not placed on an annual basis under section 47 (c). In addition to the qualifications, limitations, and exceptions provided in sections 336 (a) and 336 (b) (1), a foreign personal holding company is subject to the provisions of sections 336 (b) (2), 336 (b) (3), and 336 (c), in the computation of its Supplement P net income. Section 336 (b) (3) provides that the net operating loss deduction provided by section 23 (s) shall not be allowed. Section 336 (c) provides the same treatment to foreign personal holding companies with respect to capital gains and losses as ordinary corporations except that no capital loss carry-over from the last taxable year beginning in 1941 is allowed. Under section 336 (b) (2) the aggregate of the deductions allowed under section 23 (a), relating to expenses, and section 23 (l), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the company shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established to the satisfaction of the Commissioner:

(a) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(b) That the property was held in the course of a business carried on bona fide for profit; and

(c) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

The burden of proof will rest upon the taxpayer to sustain the deduction claimed. If a United States shareholder, in computing his distributive share of the undistributed Supplement P net income of a foreign personal holding company to be included in gross income in his individual return (see section 337 and § 29.337–1), claims deductions for expenses and depreciation allocable to the operation and maintenance of property owned or operated by the company, in an aggregate amount in excess of the rent or other compensation received for the use of, or the right to use, the property, he shall attach to his income tax return a statement setting forth his claim for allowance of the additional deductions together with a complete statement of the facts and circumstances pertinent to his claim and the arguments on which he relies. Such statement shall set forth:

(1) A description of the property;

(2) The cost or other basis to the corporation and the nature and value of the consideration paid for the property;

(3) The name and address of the person from whom acquired and the date thereof;

(4) The name and address of the person to whom leased or rented, or the person permitted to use the property, and the number of shares of stock, if any, held by such person and the members of his family;

(5) The nature and gross amount of the rent or other compensation received for the use of, or the right to use, the property during the taxable year and for each of the five preceding years and the amount of the expenses incurred with respect to, and the depreciation sustained on, the property for such years;

(6) Evidence that the rent or other compensation was the highest obtainable and, if none was received, a statement of the reasons therefor;

(7) A copy of the contract, lease, or rental agreement;

(8) The purpose for which the property was used;

(9) The business carried on by the corporation with respect to which the property was held and the gross income, expenses, and net income derived from the conduct of such business for the taxable year and for each of the five preceding years;

(10) A statement of any reasons which existed for expectation that the operation of the property would be profitable, or a statement of the necessity for the use of the property in the business of the corporation, and the reasons why the property was acquired; and

(11) Any other information pertinent to the taxpayer's claim.

§ 29.336–2 *Illustration of computation of Supplement P net income and undistributed Supplement P net income.* The method of computation of the Supplement P net income and undistributed Supplement P net income may be illustrated as follows:

Example. The following facts exist with respect to the M Corporation, a foreign personal holding company, for the calendar year 1942:

The gross income of the corporation as defined in section 334 amounts to $300,000, of which $85,000 represents its distributive share of the undistributed Supplement P net income of another foreign personal holding company in which it is a shareholder, $200,000 consists of dividends, $10,000 consists of interest, and the remainder ($5,000) consists of rent received from the principal shareholder of the corporation for the use of property owned by the corporation.

The expenses of the corporation amount to $85,000, of which $75,000 is allocable to the maintenance and operation of the property used by the principal shareholder and $10,000 consists of ordinary and necessary office expenses allowable as a deduction. The claim for deduction for the expenses of, and depreciation on, the rented property in excess of the rent received for its use is not established as provided in section 336 (b) (2). The yearly depreciation on the rented property amounts to $30,000.

Federal income tax withheld at the source on the income of the corporation from sources within the United States amounts to $59,125.

No gain from the sale or exchange of stock or securities is realized during the taxable year, but losses in the amount of $10,000 are sustained from the sale of stock or securities which constitute capital assets. Such losses are not allowed as a deduction in any amount under the provisions of sections 117 and 336 (c).

Contributions payment of which is made to or for the use of donees described in section 23 (q), for the purposes therein specified, amount to $15,000, of which $5,000 is deductible in computing net income under section 21.

Dividends paid by the corporation to its shareholders during the taxable year amount to $50,000.

The net income for the purposes of computing the Supplement P net income of the corporation (including the distributive share of the undistributed Supplement P net income of the other foreign personal holding company) is $180,000, computed as follows (assuming for the purposes of this example only that the expenses of, and depreciation on, the rented property are deductible under section 23):

Income (Section 22)

Dividends		$200,000
Interest		10,000
Rent		5,000
Gross income as defined in section 22		215,000
Add:		
Distributive share of undistributed Supplement P net income of the other foreign personal holding company (considered as a dividend)		85,000
Gross income as defined in section 334		300,000

Deductions (Section 23)

Expenses allocable to operation of the rented property	$75,000	
Depreciation of the rented property	30,000	
Ordinary and necessary expenses (office)	10,000	
Contributions (within the 5 percent limitation specified in section 23 (q)	5,000	
		120,000
Net income for purposes of computing Supplement P net income		180,000

The Supplement P net income and the undistributed Supplement P net income of the corporation are $210,875 and $160,875, respectively, computed as follows:

Net income for purposes of computing Supplement P net income		$180,000
Add (see section 336 (b)):		
Contributions deductible in computing net income under section 21	$5,000	
Excess property expenses and depreciation over amount of rent received for use of property ($105,000−$5,000)	100,000	
	105,000	
Deduct (see section 336 (a)):		
Federal income taxes	$59,125	
Contributions within the 15 percent limitation specified in section 336 (a) (2)	15,000	
	74,125	
Net additions under section 336		30,875
Supplement P net income		210,875
Less:		
Basic surtax credit for dividends paid (see section 335)		50,000
Undistributed Supplement P net income		160,875

SEC. 337. CORPORATION INCOME TAXED TO UNITED STATES SHAREHOLDERS [as amended by sec. 126 (g), Rev. Act 1942].

(a) *General rule.* The undistributed Supplement P net income of a foreign personal holding company shall be included in the gross income of the citizens or residents of the United States, domestic corporation, domestic partnerships, and estates or trusts (other than estates or trusts the gross income of which under this chapter includes only income from sources within the United States), who are shareholders in such foreign personal holding company (hereinafter called "United States shareholders") in the manner and to the extent set forth in this Supplement.

(b) *Amount included in gross income.* Each United States shareholder, who was a shareholder on the day in the taxable year of the company which was the last day on which a United States group (as defined in section 331 (a) (2)) existed with respect to the company, shall include in his gross income, as a dividend for the taxable year in which or with which the taxable year of the company ends, the amount he would have received as a dividend if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed Supplement P net income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(c) *Credit for obligations of United States and its instrumentalities.* Each United States shareholder shall be allowed a credit against net income, for the purpose of the tax imposed by section 11, 13, 14, 201, 204, 207, or 362, of his proportionate share of the interest specified in section 25 (a) (1) or (2) which is included in the gross income of the company otherwise than by the application of the provisions of section 334 (b) (relating to the inclusion in the gross income of a foreign personal holding company of its distributive share of the undistributed Supplement P net income of another foreign personal holding company in which it is a shareholder). If the foreign personal holding company elects under section 125 to treat the premium on bonds, the interest on which is allowable as a credit under section 25 (a) (1) or (2), as amortizable, for the purposes of the preceding sentence each United States shareholder's proportionate share of such interest received by the foreign personal holding company shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 23 (v) as is attributable to such share.

(d) *Information in return.* Every United States shareholder who is required under subsection (b) to include in his gross income any amount with respect to the undistributed Supplement P net income of a foreign personal holding company and who, on the last day on which a United States group existed with respect to the company, owned 5 per centum or more in value of the outstanding stock of such company, shall set forth in his return in complete detail the gross income, deductions and credits, net income, Supplement P net income, and undistributed Supplement P net income of such company.

(e) *Effect on capital account of foreign personal holding company.* An amount which bears the same ratio to the undistributed Supplement P net income of the foreign personal holding company for its taxable year as the portion of such taxable year up to and including the last day on which a United States group existed with respect to the company bears to the entire taxable year, shall, for the purpose of determining the effect of distribution in subsequent taxable years by the corporation, be considered as paid-in surplus or as a contribution to capital and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend, directly or indirectly, in the gross income of United States shareholders.

(f) *Basis of stock in hands of shareholders.* The amount required to be included in the gross income of a United States shareholder under subsection (b) shall, for the purpose of adjusting the basis of his stock with respect to which the distribution would have been made (if it had been made), be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in the last determination of the shareholder's tax liability, made before the expiration of seven years after the date prescribed by law for filing the return.

(g) *Basis of stock in case of death.* For basis of stock or securities in a foreign personal holding company acquired from a decedent, see section 113 (a) (5).

(h) *Liquidation.* For amount of gain taken into account on liquidation of foreign personal holding company, see section 115 (c).

(i) *Period of limitation on assessment and collection.* For period of limitation on assessment and collection without assessment, in case of failure to include in gross income the amount properly includible therein under subsection (b), see section 275 (d).

§ 29.337–1 *Income of foreign personal holding companies taxed to United States shareholders*—(a) *General rule.* Supplement P (sections 331 to 340, inclusive) does not impose a tax on foreign personal holding companies. The undistributed Supplement P net income of such companies, however, must be included in the manner and to the extent set forth in this section, in the gross income of their "United States shareholders," that is, the shareholders who are individual citizens or residents of the United States, domestic corporations, domestic partnerships (see section 3797 (a)), and estates or trusts other than estates or trusts the gross income of which under chapter 1 includes only income from sources within the United States.

(b) *Amount includible in gross income.* Each United States shareholder, who was a shareholder on the day in the taxable year of the foreign personal holding company which was the last day on which a United States group (see section 331 (a) (2) and § 29.331–3) existed with respect to the company, shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the company ends, the amount he would have received as a dividend if on such last day there had been distributed by the company and received by the shareholders an amount which bears the same ratio to the undistributed Supplement P net income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

The undistributed Supplement P net income of the foreign personal holding company is includible only in the gross income of the United States shareholders who were shareholders in the company on the last day of its taxable year on which the United States group existed with respect to the company. Such United States shareholders, accordingly, are determined by the stock holdings as of such specified time. This rule applies to every United States shareholder who was a shareholder in the company at the specified time regardless of whether the United States shareholder is included within the United States group. For example, a domestic corporation which is a United States shareholder at the specified time must return its distributive share in the undistributed Supplement P net income even though the domestic corporation cannot be included within the United States group since, under section 333 (a) (1) and § 29.333 (a)–2, the stock it owns in the foreign corporation is considered as being owned proportionately by its shareholders for the purpose of determining whether the foreign corporation is a foreign personal holding company.

The United States shareholders must include in their gross income their distributive shares of that proportion of the undistributed Supplement P net income for the taxable year of the company which is equal in ratio to that which the portion of the taxable year up to and including the last day on which the United States group with respect to the company existed bears to the entire taxable year. Thus, if the last day in the taxable year on which the required United States group existed was also the end of the taxable year, the portion of the taxable year up to and including such last day would be equal to 100 percent and in such case, the United States shareholders would be required to return their distributive shares in the entire

undistributed Supplement P net income. But if the last day on which the required United States group existed was September 30, and the taxable year was a calendar year, the portion of the taxable year up to and including such last day would be equal to nine-twelfths and in that case, the United States shareholders would be required to return their distributive shares in only nine-twelfths of the undistributed Supplement P net income.

The amount which each United States shareholder must return is that amount which he would have received as a dividend if the above specified portion of the undistributed Supplement P net income had in fact been distributed by the foreign personal holding company as a dividend on the last day of its taxable year on which the required United States group existed. Such amount is determined, therefore, by the interest of the United States shareholder in the foreign personal holding company, that is, by the number of shares of stock owned by the United States shareholder and the relative rights of his class of stock, if there are several classes of stock outstanding. Thus, if a foreign personal holding company has both common and preferred stock outstanding and the preferred shareholders are entitled to a specified dividend before any distribution may be made to the common shareholders, then the assumed distribution of the stated portion of the undistributed Supplement P net income must first be treated as a payment of the specified dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

The assumed distribution of the required portion of the undistributed Supplement P net income must be returned as dividend income by the United States shareholders for their respective taxable years in which or with which the taxable year of the foreign personal holding company ends. For example, if the M Corporation whose taxable year is the calendar year is a foreign personal holding company for 1942, and if A, one of its United States shareholders, makes returns on a calendar year basis, while B, another United States shareholder, makes returns on the basis of a fiscal year ending November 30, A must return his assumed dividend as income for the taxable year 1942, and B must return his distributive share as income for the fiscal year ending November 30, 1943. In applying this rule, the date as of which the United States group last existed with respect to the company is immaterial. Thus, in the foregoing example, if September 30, 1942, was the last day on which the United States group with respect to the M Corporation existed, B would still be required to return his assumed dividend as income for the fiscal year ending November 30, 1943, even though September 30, 1942, the date as of which the distribution is assumed to have been made, does not fall within such fiscal year.

§ 29.337–2 *Credit for obligations of the United States.* Each United States shareholder required to return his distributive share in the undistributed Supplement P net income of a foreign personal holding company for any taxable year is allowed, for purposes of the tax imposed by section 11, 13, 14, 201, 204, 207, or 362, a credit against his net income for his proportionate share of whatever interest on obligations of the United States or its instrumentalities (as specified in section 25 (a) (1) and (2)) may be included in the gross income of the company for such taxable year, with the exception of any such interest as may be so included by reason of the application of the provisions of section 334 (b) and § 29.334–2. (For reduction of credit for such interest on account of amortizable bond premium, see § 20.125–9.)

For example, the M Corporation is a foreign personal holding company which owns all the stock of the N Corporation, another foreign personal holding company. Both companies receive interest on obligations of the United States or its instrumentalities as specified in section 25 (a) (1) and (2). In applying the credit allowable under section 337 (c), the United States shareholders of the M Corporation would be entitled to a credit only for their proportionate shares of the interest received by that company and not for any part of the interest received by the N Corporation, regardless of whether the interest received by the N Corporation is included in the gross income of the M Corporation, as an actual dividend or as a constructive dividend under section 334 (b).

§ 29.337–3 *Information in return.* The information required by section 337 (d) in the returns of certain United States shareholders relates only to the taxable year of a foreign personal holding company for which is computed such corporation's undistributed Supplement P net income, all or part of which must be included in gross income by the United States shareholder of whom the information is required. The information shall be submitted as a part of the income tax returns required by the Internal Revenue Code of such persons, in the form of a statement attached to the return.

§ 29.337–4 *Effect on capital account of foreign personal holding company and basis of stock in hands of shareholders.* Sections 337 (e) and 337 (f) are designed to prevent double taxation with respect to the undistributed Supplement P net income of foreign personal holding companies. The application of such sections may be illustrated by the following examples:

Example (1). The M Corporation is a foreign personal holding company. Seventy-five percent in value of its capital stock is owned by A, a citizen of the United States, and the remainder, or 25 percent, of its stock is owned by B, a nonresident alien individual. For the calendar year 1942 the M Corporation has an undistributed Supplement P net income of $100,000. A is required to include $75,000 of such income in gross income in his return for the calendar year 1942. The $100,000 is treated as paid-in surplus or as a contribution to the capital of the M Corporation and its accumulated earnings and profits as of the close of the calendar year 1942 are correspondingly reduced. If after treating such $100,000 as paid-in surplus or as a contribution to capital, the M Corporation has no accumulated earnings and profits at the close of 1942, and if for the calendar year 1943, the M Corporation had no earnings and profits, but distributed $100,000, the amount so distributed would be tax-free in the hands of both A and B. If, however, after treating the $100,000 as paid-in surplus or as a contribution to capital, the M Corporation had accumulated earnings and profits of $100,000 at the close of 1942, the facts otherwise being the same, the distributions in 1943 would be taxable to A, and the taxability of such distributions to B would depend upon the application of section 119 (a) (2) (B), relating to the treatment of dividends from a foreign corporation as income from sources within or without the United States.

Example (2). In example (1) assume the basis of A's stock to be $300,000. If A includes in gross income in his return for the calendar year 1942, $75,000 as a constructive dividend from the M Corporation, the basis of his stock would be $375,000. After the $75,000 is distributed by the M Corporation tax-free the basis of A's stock, assuming no other changes, would again be $300,000. If A failed to include the $75,000 in gross income in his return as required by the Internal Revenue Code and his failure was not discovered until after the 7-year period of limitations had expired, the application of the rule would not increase the basis of A's stock. The subsequent tax-free distribution of $75,000 would reduce his basis to $225,000, thus tending to compensate for his failure to include the amount of $75,000 in his gross income. If the undistributed Supplement P net income of the M Corporation is readjusted within the statutory period of limitations, thus increasing or decreasing the amount A would have to include in his gross income, proper adjustment is required to be made to the basis of A's stock on account of such readjustment.

SEC. 338. INFORMATION RETURNS BY OFFICERS AND DIRECTORS.

(a) *Monthly returns.* On the fifteenth day of each month each individual who on such day is an officer or a director of a foreign corporation which, with respect to its taxable year preceding the taxable year (whether beginning on, before, or after January 1, 1939) in which such month occurs, was a foreign personal holding company, shall file with the Commissioner a return setting forth with respect to the preceding calendar month the name and address of each shareholder, the class and number of shares held by each, together with any changes in stockholdings during such period, the name and address of any holder of securities convertible into stock of such corporation, and such other information with respect to the stock and securities of the corporation as the Commissioner with the approval of the Secretary shall by regulations prescribed as necessary for carrying out the provisions of this title. The Commissioner, with the approval of the Secretary, may by regulations prescribe, as the period with respect to which returns shall be filed, a longer period than a month. In such case the return shall be due on the fifteenth day of the succeeding period, and shall be filed by the individuals who on such day are officers and directors of the corporation.

(b) *Annual returns.* On the sixtieth day after the close of the taxable year of a foreign personal holding company each individual who on such sixtieth day is an officer or director of the corporation shall file with the Commissioner a return setting forth—

(1) In complete detail the gross income, deductions and credits, net income, Supplement P net income, and undistributed Supplement P net income of such foreign personal holding company for such taxable year; and

(2) The same information with respect to such taxable year as is required in subsection (a); except that if all the required returns with respect to such year have been filed under subsection (a) no information under this paragraph need be set forth in the return filed under this subsection.

§ 29.338–1 *Information returns by officers and directors of certain foreign corporations*—(a) *Requirement for filing returns*—(1) *General.* Under section 338 (a), on the 15th day of each month each individual who on such day is an officer or a director of a foreign corporation which, with respect to its taxable year preceding the taxable year in which such month occurs, was a foreign personal holding company, is required to file with the Commissioner a monthly information return as provided in section 338 (a) and this section.

(2) *Returns for a period exceeding one month.* In the case of a foreign personal holding company which before the close of its taxable year distributed to its shareholders 90 percent or more of its Supplement P net income as defined in section 336, or which has no such net income for such taxable year, the following periods are prescribed with respect to which information returns on Form 957 shall be filed during the following year:

The return for the last month of the preceding taxable year shall be filed on the 15th day of the first month following the close of such taxable year. Subsequent returns shall be filed for each 6-month period following the close of such taxable year and shall be filed on the 15th day of the first month following such period. If any change in the stock holdings or in the holdings of securities convertible into stock of the corporation occurs during such periods or if a resolution or plan (including any amendments thereof or supplements thereto) for the dissolution of the corporation or for the liquidation of the whole or any part of its capital stock is adopted during such periods a monthly information return must also be filed on the 15th day of the month following each month in which the change occurs or the resolution or plan is adopted. In any case under this paragraph where the date for filing a monthly return coincides with the date for filing the return for a 6-month period only the return for the 6-month period need be filed.

(3) *Returns jointly made.* If two or more officers or directors of a foreign corporation are required to file information returns for any period under section 338 (a) and this section, any two or more of such officers or directors may, in lieu of filing separate returns for such period, jointly execute and file one return.

(b) *Form of return.* The return under section 338 (a) and this section shall be made on Form 957, copies of which, upon request, may be procured from any collector. Each officer or director should carefully prepare his return so as to set forth fully and clearly the information called for therein and by the applicable regulations. Returns which have not been so prepared will not be considered as meeting the requirements of the Internal Revenue Code.

(c) *Contents of return.* The return shall, in accordance with the provisions of this section and the instructions on the form, set forth with respect to the preceding period the following information:

(1) Name and address of corporation;

(2) Kind of business in which the corporation is engaged;

(3) Date of incorporation;

(4) The country under the laws of which the corporation is incorporated;

(5) Number of shares and par value of common stock of the corporation outstanding as of the beginning and end of the period;

(6) Number of shares and par value of preferred stock of the corporation outstanding as of the beginning and end of the period, the rate of dividend on such stock and whether such dividend is cumulative or noncumulative;

(7) A description of the convertible securities issued by the corporation, including a statement of the face value of, and rate of interest on, such securities;

(8) The name and address of each shareholder, the class and number of shares held by each, together with any changes in stock holdings during such period;

(9) The name and address of each holder of securities convertible into stock of the corporation, the class, number, and face value of the securities held by each, together with any changes in the holdings of such securities during the period;

(10) A certified copy of any resolution or plan, and any amendments thereof or supplements thereto, for or in respect of the dissolution of the corporation or the liquidation of the whole or any part of its capital stock; and

(11) Such other information as may be required by the return form.

If a person is required to file a return under section 338 (a) and this section with respect to more than one foreign corporation, a separate return must be filed with respect to each foreign corporation.

(d) *Verification of returns.* All returns required by section 338 (a) and this section shall be verified under oath or affirmation in the same manner as prescribed in § 29.51–4.

(e) *Penalties.* For criminal penalties for failure to file the returns required by section 338 (a) and this section, see section 340.

§ 29.338–2 *Annual information returns by officers and directors of certain foreign corporations*—(a) *Requirement for filing returns*—(1) *General.* Under section 338 (b), on the sixtieth day after the close of the taxable year of a foreign personal holding company each individual who on such sixtieth day is an officer or director of the corporation shall file with the Commissioner an annual information return as provided in section 338 (b) and this section.

(2) *Returns jointly made.* If two or more officers or directors of a foreign corporation are required to file annual information returns under section 338 (b) and this section for any taxable year of the corporation, any two or more of such officers or directors may in lieu of filing separate annual returns for such taxable year, jointly execute and file one annual return.

(b) *Form of return.* The return under section 338 (b) and this section shall be made on Form 958, copies of which, upon request, may be procured from any collector. Each officer or director should carefully prepare his return so as to set forth fully and clearly the information called for therein and by the applicable regulations. Returns which have not been so prepared will not be considered as meeting the requirements of the Internal Revenue Code.

(c) *Contents of return.* The return shall, in accordance with the provisions of this section and the instructions on the form, set forth with respect to the taxable year of the foreign personal holding company the following information:

(1) The gross income, deductions and credits, net income, Supplement P net income, and undistributed Supplement P net income of the foreign personal holding company for such taxable year, in complete detail;

(2) The same information with respect to such taxable year which is required by section 338 (a) and § 29.338–1 (c), except that if all the required returns with respect to such year have been filed under section 338 (a) and § 29.338–1, no information under section 338 (b) (2) and this paragraph need be set forth in such annual return; and

(3) Such other information as may be required by the return form.

(d) *Verification of returns.* All returns required by section 338 (b) and this section shall be verified under oath or affirmation in the same manner as prescribed in § 29.51–4.

(e) *Penalties.* For criminal penalties for failure to file the returns required by section 338 (b) and this section, see section 340.

§ 29.338–3 *Time and place of filing returns.* Returns required by section 338 and §§ 29.338–1 and 29.338–2 shall be filed with the Commissioner of Internal Revenue, Washington, D. C., attention Income Tax Unit, Records Division, and will be considered filed within the time or times required by law if, within such time or times, such returns are made and placed in the mails in due course, properly addressed and postage paid, provided they are actually received in the office of the Commissioner of Internal Revenue, Washington, D. C., even though received after such time or times.

SEC. 339. INFORMATION RETURNS BY SHAREHOLDERS.

(a) *Monthly returns.* On the fifteenth day of each month each United States shareholder, by or for whom 50 per centum or more in value of the outstanding stock of a foreign corporation is owned directly or indirectly (including in the case of an individual, stock owned by the members of his family as defined in section 333 (a) (2)), if such foreign corporation with respect to its taxable year preceding the taxable year (whether beginning on, before, or after January 1, 1939) in which such month occurs was a foreign personal holding company, shall file with the Commissioner a return

setting forth with respect to the preceding calendar month the name and address of each shareholder, the class and number of shares held by each, together with any changes in stockholdings during such period, the name and address of any holder of securities convertible into stock of such corporation, and such other information with respect to the stock and securities of the corporation as the Commissioner with the approval of the Secretary shall by regulations prescribe as necessary for carrying out the provisions of this title. The Commissioner, with the approval of the Secretary, may by regulations prescribe, as the period with respect to which returns shall be filed, a longer period than a month. In such case the return shall be due on the fifteenth day of the succeeding period, and shall be filed by the persons who on such day are United States shareholders.

(b) *Annual returns.* On the sixtieth day after the close of the taxable year of a foreign personal holding company each United States shareholder by or for whom on such sixtieth day 50 per centum or more in value of the outstanding stock of such company is owned directly or indirectly (including in the case of an individual, stock owned by members of his family as defined in section 333 (a) (2)), shall file with the Commissioner a return setting forth the same information with respect to such taxable year as is required in subsection (a); except that if all the required returns with respect to such year have been filed under subsection (a) no return shall be required under this subsection.

§ 29.339–1 *Information returns by shareholders of certain foreign corporations*—(a) *Requirement for filing returns*—(1) *General.* On the 15th day of each month each United States shareholder, by or for whom 50 percent or more in value of the outstanding stock of a foreign corporation is owned, directly or indirectly (including, in the case of an individual, stock owned by members of his family, as defined in section 333 (a) (2)), if such foreign corporation with respect to its taxable year preceding the taxable year in which such month occurs was a foreign personal holding company, shall file with the Commissioner an information return as provided in section 339 (a) and this section.

(2) *Returns for a period exceeding one month.* In the case of a foreign personal holding company which before the close of its taxable year distributed to its shareholders 90 percent or more of its Supplement P net income, or which has no such net income for such taxable year, the periods with respect to which information returns under section 339 (a) shall be filed shall be the same as the periods prescribed in § 29.338–1 (a) (2).

(3) *Duplicate returns.* If a shareholder in a foreign corporation files, as an officer or director in such corporation, the returns required by section 338 (a) and § 29.338–1, such returns shall be considered as returns filed under section 339 (a).

(b) *Form of return.* The return under section 339 (a) and this section shall be made on Form 957, copies of which, upon request, may be procured from any collector. Each shareholder should carefully prepare his return so as to set forth fully and clearly the information called for therein and by the applicable regulations. Returns which have not been so prepared will not be considered as meeting the requirements of the Internal Revenue Code.

(c) *Contents of return.* The return shall, in accordance with the provisions of this section and the instructions on the form, set forth with respect to the preceding period the same information as required to be shown on that form by section 338 (a) and § 29.338–1 (c).

If a person is required to file a return under section 339 (a) and this section with respect to more than one foreign corporation, a separate return must be filed with respect to each foreign corporation.

(d) *Verification of returns.* All returns required by section 339 (a) and this section shall be verified under oath or affirmation in the same manner as prescribed in § 29.51–4.

(e) *Penalties.* For criminal penalties for failure to file the returns required by section 339 (a) and this section, see section 340.

§ 29.339–2 *Annual information returns by shareholders of certain foreign corporations*—(a) *Requirement for filing returns*—(1) *General.* Under section 339 (b), on the sixtieth day after the close of the taxable year of a foreign personal holding company, each United States shareholder, by or for whom on such sixtieth day 50 percent or more in value of the outstanding stock of the company is owned, directly or indirectly (including in the case of an individual, stock owned by members of his family as defined in section 333 (a) (2)), shall file with the Commissioner an information return as provided in section 339 (b) and this section.

(2) *Duplicate returns.* If a shareholder in a foreign corporation files, as an officer or director in such corporation, the returns required by section 338 (b) and § 29.338–2, such returns shall be considered as returns filed under section 339 (b).

(b) *Form of return.* The return under section 339 (b) and this section shall be made on Form 957, copies of which, upon request, may be procured from any collector. Each shareholder should carefully prepare his return so as to set forth fully and clearly the information called for therein and by the applicable regulations. Returns which have not been so prepared will not be considered as meeting the requirements of the Internal Revenue Code.

(c) *Contents of return.* The return shall, in accordance with the provisions of this section and the instructions on the form, set forth with respect to the taxable year of the foreign personal holding company the same information which is required under section 339 (a), § 29.338–1 (c), and § 29.339–1 (c), except that if all the required returns with respect to such year have been filed under section 339 (a) and § 29.339–1, no return under section 339 (b) and this section is required.

If a person is required to file an annual return under section 339 (b) and this section with respect to more than one foreign personal holding company, a separate return must be filed with respect to each foreign personal holding company.

(d) *Verification of returns.* All returns required by section 339 (b) and this section shall be verified under oath or affirmation in the same manner as prescribed in § 29.51–4.

(e) *Penalties.* For criminal penalties for failure to file the returns required by section 339 (b) and this section, see section 340.

§ 29.339–3 *Time and place of filing returns.* Returns required by section 339 and §§ 29.339–1 and 29.339–2 shall be filed with the Commissioner of Internal Revenue, Washington, D. C., attention Income Tax Unit, Records Division, and will be considered filed within the time or times required by law if, within such time or times, such returns are made and placed in the mails in due course, properly addressed and postage paid, provided they are actually received in the office of the Commissioner of Internal Revenue, Washington, D. C., even though received after such time or times.

SEC. 340. PENALTIES.

Any person required under section 338 or 339 to file a return, or to supply any information, who willfully fails to file such return, or supply such information, at the time or times required by law or regulations, shall, in lieu of the penalties provided in section 145 (a) for such offense, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $2,000, or imprisoned for not more than one year, or both.

REGULATED INVESTMENT COMPANIES

SEC. 361. DEFINITION [as amended by sec. 170 (a), Rev. Act 1942].

(a) *In general.* For the purposes of this chapter, the term "regulated investment company" means any domestic corporation (whether chartered or created as an investment trust, or otherwise), other than a personal holding company as defined in section 501, which at all times during the taxable year is registered under the Investment Company Act of 1940 (54 Stat. 789, 15 U. S. C., 1940 ed., secs. 80 a–1 to 80 b–2), or that Act, as amended, either as a management company or as a unit investment trust, or which is a common trust fund or similar fund excluded by section 3 (c) (3) of such Act from the definition of "investment company" and is not included in the definition of "common trust fund" by section 169.

(b) *Limitations.* Despite the provisions of subsection (a), a corporation shall not be considered a regulated investment company for any taxable year unless—

(1) At least 90 per centum of its gross income is derived from dividends, interest, and gains from the sale or other disposition of stock or securities; and

(2) Less than 30 per centum of its gross income is derived from the sale or other disposition of stock or securities held for less than three months; and

(3) At the close of each quarter of the taxable year (A) at least 50 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other regulated investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 per centum of the value of the total assets of the taxpayer and to not more than 10 per centum of the outstanding voting securities of such issuer, and (B) not more than 25 per centum of the value of its total assets is invested in the securities (other than Gov-

ernment securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Commissioner with the approval of the Secretary, to be engaged in the same or similar trades or businesses or related trades or businesses. For the purposes of clause (B), in ascertaining the value of the taxpayer's investment in the securities of an issuer, there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer, as determined under regulations prescribed by the Commissioner and approved by the Secretary. The term "controls", as used in this paragraph, means the ownership in a corporation of 20 per centum or more of the total combined voting power of all classes of stock entitled to vote. The term "controlled group", as used in this paragraph, means one or more chains of corporations connected through stock ownership with the taxpayer if (i) 20 per centum or more of the total combined voting power of all classes of stock entitled to vote of each of the corporations (except the taxpayer) is owned directly by one or more of the other corporations, and (ii) the taxpayer owns directly 20 per centum or more of the total combined voting power of all classes of stock entitled to vote, of at least one of the other corporations. The term "value" as used in this paragraph means, with respect to securities (other than those of majority-owned subsidiaries) for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the board of directors, except that in the case of securities of majority-owned subsidiaries which are investment companies such fair value shall not exceed market value or asset value, whichever is higher. All other terms used in the preceding provisions of this paragraph shall have the same meaning as when used in the Investment Company Act of 1940, or that Act as amended. A corporation which meets the foregoing requirements of this paragraph at the close of any quarter shall not lose its status as a regulated investment company because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A corporation which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a regulated investment company if such discrepancy is eliminated within thirty days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for the purposes of applying the preceding sentence. A corporation which meets such requirements at the close of its first full quarter after the date of the enactment of the Revenuse Act of 1942, or eliminates any discrepancy between the value of its investments and such requirements existing at the close of such quarter within thirty days thereafter, shall be deemed to have met such requirements at all previous times; and

(4) It files with its return for the taxable year an election to be a regulated investment company or has made such election for a previous taxable year which began after December 31, 1941.

§ 29.361–1 *Definition of a regulated investment company* — (a) *Limitations upon source of income.* Section 361 (b) (1) and (2) provides that at least 90 percent of the corporation's gross income for the taxable year shall be derived from dividends, interest, and gains from the sale or other disposition of stock or securities, and less than 30 percent of the corporation's gross income shall have been derived from the sale or other disposition of stock or securities held for less than three months. As to the definition of the term "corporation", see section 3797 (a) (3). In determining the percentage of the corporation's gross income which has been derived from such sources, a loss from the sale or other disposition of stock or securities does not enter into the computation. A determination of the period for which stock or securities have been held shall be governed by the provisions of section 117 (h) in so far as applicable.

(b) *Limitations requiring diversification of investments.* Section 361 (b) (3), with respect to diversification of investments, requires, in clause (A), that at the close of each quarter of the taxable year at least 50 percent of the value of the total assets of the corporation be represented by cash and cash items (including receivables), Government securities, securities of other regulated investment companies, and other securities. For the purpose of this calculation, investments in securities other than Government securities or securities of other regulated investment companies shall be limited in respect of any one issuer to an amount not greater than 5 percent of the value of the total assets of the corporation and to not more than 10 percent of the outstanding voting securities of such issuer. Assuming that at least 50 percent of the value of the total assets of the corporation satisfies these requirements, and that the limiting provisions of clause (B) are not violated, the corporation will satisfy the requirements of section 361 (b) (3), notwithstanding that the remaining assets do not satisfy the diversification requirements of clause (A). For example, a corporation may own all the stock of another corporation, provided it otherwise meets the requirements of clauses (A) and (B).

Clause (B) prohibits the investment at the close of each quarter of the taxable year of more than 25 percent of the value of the total assets of the corporation (including the 50 percent or more mentioned in clause (A)) in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers, which the corporation controls and which are engaged in the same or similar trades or businesses or related trades or businesses, including such issuers that are merely a part of a unit contributing to the completion and sale of a product or the rendering of a particular service. Two or more issuers are not considered as being in the same or similar trades or businesses merely because they are engaged in the broad field of manufacturing or of any other general classification of industry, but issuers shall be construed to be engaged in the same or similar trades or businesses if they are engaged in a distinct branch of business, trade, or manufacture in which they render the same kind of service or produce or deal in the same kind of product, and such service or products fulfill the same economic need. If two or more issuers produce more than one product or render more than one type of service, then the chief product or service of each shall be the basis for determining whether they are in the same trade or business. The term "controls," "controlled group," and "value" are defined for the purposes of this paragraph in section 361 (b) (3). All other terms used in this section have the same meaning as when used in the Investment Company Act of 1940, or that Act as amended. In determining the value of the investment company's investment in the securities of any one issuer, there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer. With respect to the effect which certain discrepancies between the value of its various investments and the requirements of section 361 (b) (3) or the elimination of such discrepancies will have on the status of a company as a regulated investment company for the purposes of these sections, see section 361 (b) (3). A company claiming to be a regulated investment company shall keep sufficient records as to investments so as to be able to show that it has complied with the provisions of section 361 (b) (3) during the taxable year. Such records shall be kept at all times available for inspection by any authorized officer or employee of the Bureau of Internal Revenue, and shall be retained as long as the contents thereof may become material in the administration of any internal-revenue law.

The requirements as to diversification under section 361 (b) (3) are illustrated by the following examples:

Example (1). Investment Company W at the close of its first quarter of the taxable year has its assets invested as follows: 5 percent in cash, 10 percent in Government securities, 20 percent in the securities of regulated investment companies as defined in section 361, 10 percent in the securities of Corporation A, 15 percent in Corporation B, 20 percent in Corporation C, and the balance, 20 percent, in the securities of various corporations, not exceeding 5 percent of its assets in any one company. Investment Company W owns 15 percent of the voting stock of Corporation C and less than 10 percent of the voting stock of the other corporations, except that it owns all of the voting stock of Corporations A and B. None of the corporations is a member of a controlled group. Investment Company W meets the requirements at the end of its first quarter under section 361 (b) (3). It complies with clause (A) since it has 55 percent of its assets invested as provided in clause (A). It complies with clause (B) since it does not have more than 25 percent of its assets invested in the securities of any one issuer, or of two or more issuers which it controls.

Example (2). Investment Company V at the close of a particular quarter of the taxable year has its assets invested as follows: 10 percent in cash, 35 percent in Government securities, 7 percent in the securities of Corporation A, 12 percent in Corporation B, 15 percent in Corporation C, and 21 percent in Corporation D. Investment Company V fails to meet the requirements of clause (A) of section 361 (b) (3) since its assets invested in Corporations A, B, C, and D exceed in

each case 5 percent of the value of the total assets of the company at the close of the particular quarter.

Example (3). Investment Company X at the close of the particular quarter of the taxable year has its assets invested as follows: 20 percent in cash and Government securities, 5 percent in Corporation A, 10 percent in Corporation B, 25 percent in Corporation C, and the other 40 percent in the securities of miscellaneous corporations, not exceeding 5 percent in any one issuer. Investment Company X owns less than 10 percent of the voting power of all of the corporations, except it owns more than 20 percent of the voting power of Corporations B and C. Corporation B manufactures radios and Corporation C acts as its distributor and also distributes radios for other companies. Investment Company X fails to meet the requirements of section 361 (b) (3) since it has 35 percent of its assets invested in the securities of two issuers which it controls and which are engaged in related trades or businesses.

Example (4). Investment Company Y at the close of the particular quarter has 15 percent of its assets invested in cash and Government securities, 30 percent in Corporation K, a regulated investment company, 10 percent in Corporation A, 20 percent in Corporation B, and the remaining 25 percent in various corporations in none of which is more than 5 percent of its assets invested. Corporation K has 20 percent of its assets invested in Corporation I, and Corporation L has 40 percent of its assets invested in Corporation B. Corporation A also has 30 percent of its assets invested in Corporation B, and owns more than 20 percent of the voting power in Corporation B. Investment Company Y owns more than 20 percent of the voting power of Corporations A and K. Corporation K owns more than 20 percent of the voting power of Corporation L, and Corporation L owns more than 20 percent of the voting power of Corporation B. Investment Company Y is disqualified under clause (B) since more than 25 percent of its assets is considered invested in Corporation B as shown by the following calculation:

Percentage of assets invested directly in Corporation B, 20.

Percentage invested through the controlled group, Y–K–L–B, 2.4, determined as follows:

40 percent of 20 percent of 30 percent=2.4.

Percentage invested in the controlled group, Y–A–B, 3, determined by taking 30 percent of 10 percent.

Total percentage of assets of Investment Company Y invested in Corporation B, 25.4.

Example (5). Investment Company Z at the close of its first full quarter after October 21, 1942 (the date of enactment of the Revenue Act of 1942) meets the requirements of section 361 (b) (3) and has 20 percent of its assets invested in Corporation A. Later during the taxable year it makes distributions to its shareholders and because of such distributions it finds at the close of the taxable year that it has more than 25 percent of its remaining assets invested in Corporation A. Investment Company Z does not lose its status as a regulated investment company because of such distributions.

(c) *Requirements as to election.* Even if an investment company satisfies the other requirements of section 361 for the taxable year, it will not be considered a regulated investment company for such year within the meaning of Supplement Q unless it elects to be a regulated investment company for such taxable year, or has made such an election for a previous taxable year. The election shall be made by the taxpayer by computing income as a regulated investment company in its return for the first taxable year to which it desires the election to be applicable. No other method of making such election is permitted. An election once made is irrevocable for the current taxable year and all succeeding taxable years.

SEC. 362. TAX ON REGULATED INVESTMENT COMPANIES [as amended by secs. 209, 211 (h), Rev. Act 1939; sec. 8 (d), Rev. Act 1940; sec. 101 (c), 2d Rev. Act 1940; sec. 103 (e), Rev. Act 1941; sec. 170 (a), Rev. Act 1942].

(a) *Earnings and profits.* The earnings and profits of a regulated investment company for any taxable year beginning after December 31, 1941 (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its net income for such taxable year.

(b) *Method of taxation of companies and shareholders.* In the case of a regulated investment company which distributes during the taxable year to its shareholders as taxable dividends other than capital gain dividends an amount not less than 90 per centum of its net income for the taxable year computed without regard to net long-term and net short-term capital gains, and complies for such year with all rules and regulations prescribed by the Commissioner, with the approval of the Secretary, for the purpose of ascertaining the actual ownership of its outstanding stock:

(1) Its Supplement Q net income shall be its adjusted net income (computed by excluding the excess, if any, of the net long-term capital gain over the net short-term capital loss, and without the net operating loss deduction provided in section 23 (s)) minus the basic surtax credit (excluding capital gain dividends) computed under section 27 (b) without the application of paragraphs (2) and (3). For the purposes of this paragraph, the net income shall be computed without regard to section 47 (c).

(2) Its Supplement Q surtax net income shall be its net income (computed by excluding the excess, if any, of the net long-term capital gain over the net short-term capital loss, and without the net operating loss deduction provided in section 23 (s)) minus the dividends (other than capital gain dividends) paid during the taxable year increased by the consent dividends credit provided by section 28. For the purposes of this paragraph and paragraph (5) the amount of dividends paid shall be computed in the same manner as provided in subsections (d), (e), (f), (g), (h), and (i) of section 27 for the purpose of the basic surtax credit provided in section 27. For the purposes of this paragraph the net income shall be computed without regard to section 47 (c).

(3) There shall be levied, collected, and paid for each taxable year upon its Supplement Q net income a tax equal to 24 per centum of the amount thereof.

(4) There shall be levied, collected, and paid for each taxable year upon its Supplement Q surtax net income a tax equal to 16 per centum of the amount thereof.

(5) There shall be levied, collected, and paid for each taxable year a tax of 25 per centum of the excess, if any, of the net long-term capital gain over the sum of the net short-term capital loss and the amount of capital gain dividends paid during the year.

(6) A capital gain dividend shall be treated by the shareholders as gains from the sale or exchange of capital assets held for more than 6 months.

(7) A capital gain dividend means any dividend or part thereof which is designated by the company as a capital gain dividend in a written notice mailed to its shareholders at any time prior to the expiration of thirty days after close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated.

§ 29.362–1 *Earnings and profits of a regulated investment company.* In the determination of the earnings and profits of a regulated investment company, such earnings and profits shall not be reduced by any amount which is not allowable as a deduction in computing its net income for such taxable year. See section 362 (a). Thus, if a corporation would have had earnings and profits of $500,000 for the taxable year except for the fact that it had a net capital loss of $100,000, which amount was not deductible in determining its net income, its earnings and profits for that year if it is a regulated investment company would be $500,000. However, in determining its accumulated earnings and profits as of the beginning of the following taxable year, the earnings and profits for the previous year to be considered in such computation would amount to $400,000 assuming that there had been no distribution from such earnings and profits. For the purpose of the earnings-and-profits concept, it is immaterial whether during the taxable year a regulated investment company is taxable under Supplement Q.

§29.362–2 *Method of taxation of regulated investment companies.* If a regulated investment company distributes during the taxable year to its shareholders as taxable dividends other than capital gain dividends an amount not less than 90 percent of its net income for the taxable year computed without regard to net long-term and net short-term capital gains, and complies for such year with the provisions of § 29.362–3 (relating to records required to be kept for the purpose of ascertaining the actual ownership of its outstanding stock), it is taxable upon its Supplement Q net income (as defined in section 362 (b) (1) at the rate of 24 percent of the amount thereof, upon its Supplement Q surtax net income (as defined in section 362 (b) (2)) at the rate of 16 percent of the amount thereof, and upon the excess of any net long-term capital gain over the sum of the net short-term capital loss and the amount of capital gain dividends (as defined in section 362 (b) (7)) paid during the year, at the rate of 25 percent of such excess. If a regulated investment company does not in a particular year distribute as taxable dividends, other than capital gain dividends, to its stockholders at least 90 percent of its net income computed without regard to net long-term and net short-term capital gains, it will, in spite of being classified as a regulated investment company, be taxed in that year as an ordinary corporation (that is, it will be entitled to the dividends received credit, but will not be entitled to the basic surtax credit). The term "taxable dividends" means dividends (as defined in section 115 after

the application of section 362 (a)) which are taxable in the hands of such shareholders as are subject to taxation under chapter 1. A taxable dividend is not distributed to its shareholders during the taxable year within the meaning of section 362 (b), unless the dividend is received by the shareholders during the taxable year of the company. See § 29.27 (b)–2, relating to when dividends are considered paid. Due to the provisions in section 362 (a) with respect to the concept of earnings and profits of a regulated investment company, even though such a company has no accumulated earnings and profits if it makes distributions during the taxable year of an amount equal to its net income for that year, regardless of the amount of losses which are not deductible against such net income, it will be allowed a basic surtax credit equal to its net income, and thus not be liable for any income tax for the taxable year provided it otherwise satisfies the requirements of Supplement Q. The terms "Supplement Q net income," "Supplement Q surtax net income," and "capital gain dividend" are defined in section 362 (b) (1), (2), and (7), respectively.

§ 29.362–3 *Records to be kept for purpose of determining whether a corporation claiming to be a regulated investment company is a personal holding company.* Every regulated investment company shall maintain in the collection district in which it is required to file its income tax return permanent records showing the information relative to the actual owners of its stock contained in the written statements required by these regulations to be demanded from the shareholders. The term "actual owner of stock," as used in these regulations, includes the person who is required to include in gross income in his return the dividends received on the stock. Such records shall be kept at all times available for inspection, by any authorized officer or employee of the Bureau of Internal Revenue, and shall be retained as long as the contents thereof may become material in the administration of any internal-revenue law. For the purpose of determining whether a domestic corporation claiming to be a regulated investment company is a personal holding company as defined in section 501, the permanent records of the company shall show the maximum number of shares of the corporation (including the number and face value of securities convertible into stock of the corporation) to be considered as actually or constructively owned by each of the actual owners of any of its stock at any time during the last half of the corporation's taxable year, as provided in section 503. Statements giving such information shall be demanded not later than 30 days after the close of the corporation's taxable year or the approval of these regulations, whichever is later, as follows:

(a) In the case of a corporation having 2,000 or more record owners of its stock on any dividend record date, from each record holder of 5 percent or more of its stock; or

(b) In the case of a corporation having less than 2,000 and more than 200 record owners of its stock, on any dividend record date, from each record holder of 1 percent or more of its stock; or

(c) In the case of a corporation having 200 or less record owners of its stock, on any dividend record date, from each record holder of one-half of 1 percent or more of its stock.

§ 29.362–4 *Additional information required in returns of shareholders.* Any person who fails or refuses to comply with the demand of a regulated investment company for the written statements which § 29.362–3 requires the company to demand from its shareholders shall submit as a part of the income tax return required by the Internal Revenue Code of such person a statement showing, to the best of his knowledge and belief:

(a) The number of shares actually owned by him at any and all times during the period for which the return is filed in any company claiming to be a regulated investment company;

(b) The dates of acquisition of any such stock during such period and the names and addresses of persons from whom it was acquired;

(c) The dates of disposiiton of any such stock during such period and the names and addresses of the transferees thereof;

(d) The names and addresses of the members of his family (as defined in section 503 (a) (2)); the names and addresses of his partners, if any, in any partnership; and the maximum number of shares, if any, actually owned by each in any corporation claiming to be a regulated investment company, at any time during the last half of the taxable year of such company;

(e) The names and addresses of any corporation, partnership, association, or trust in which he had a beneficial interest to the extent of at least 10 percent at any time during the period for which such return is made, and the number of shares of any corporation claiming to be a regulated investment company actually owned by each;

(f) The maximum number of shares (including the number and face value of securities convertible into stock of the corporation) in any domestic corporation claiming to be a regulated investment company to be considered as constructively owned by such individual at any time during the last half of the corporation's taxable year, as provided in section 503 and §§ 29.503 (a)–1 to 29.503 (a)–7, inclusive, and § 29.503 (b)–1; and

(g) The amount and date of receipt of each dividend received during such period from every corporation claiming to be a regulated investment company.

When making demand for the written statements required of each shareholder under these regulations, the company shall inform each of the shareholders of his duty to submit as a part of his income tax return the statements which are required by this section if he fails or refuses to comply with such demand. A list of the persons failing or refusing to comply in whole or in part with a company's demand shall be maintained as a part of its records required by these regulations. A company which fails to keep such records to show the actual ownership of its outstanding stock as are required by these regulations, or which may be required from time to time by any rule or regulation prescribed by the Commissioner, with the approval of the Secretary, for such purpose, shall not be taxable as a regulated investment company.

Nothing in these regulations shall be construed to relieve regulated investment companies or their shareholders from the duty of filing information returns required by regulations prescribed under sections 147 and 148.

§ 29.362–5 *Method of taxation of shareholders of regulated investment companies.* Shareholders who receive capital gain dividends from a regulated investment company distributed during a taxable year of the regulated investment company for which it is taxable under section 362 (b) shall treat such dividends as gains from the sale or exchange of capital assets held for more than six months. A capital gain dividend is defined in section 362 (b) (7) as any dividend or part thereof which is designated by a regulated investment company as a capital gain dividend in a written notice mailed to its shareholders at any time prior to the expiration of 30 days after the close of its taxable year. If the aggregate amount so designated with respect to the taxable year is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. Thus, if a regulated investment company making its return on the calendar year basis advised its shareholders by written notice mailed December 30, 1942, that of a distribution of $500,000 made December 15, 1942, $200,000 constituted a capital gain dividend, amounting to $2 per share, and it was later discovered that an error had been made in determining the excess of the net long-term capital gain over the net short-term capital loss of the taxable year and that instead of such excess being $200,000 it was $100,000, then instead of each shareholder having received a capital gain dividend of $2 per share he would have received a capital gain dividend of $1 per share.

EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

SEC. 371. NONRECOGNITION OF GAIN OR LOSS [as amended by sec. 171 (a) (b) (g), Rev. Act 1942].

(a) *Exchanges of stock or securities only.* No gain or loss shall be recognized to the transferor if stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary company are transferred to such corporation or to an associate company thereof which is a registered holding company or a majority-owned sub-

sidiary company solely in exchange for stock or securities (other than stock or securities which are nonexempt property), and the exchange is made by the transferee corporation in obedience to an order of the Securities and Exchange Commission.

(b) *Exchanges and sales of property by corporations.* No gain shall be recognized to a transferor corporation which is a registered holding company or an associate company of a registered holding company, if such corporation, in obedience to an order of the Securities and Exchange Commission transfers property in exchange for property, and such order recites that such exchange by the transferor corporation is necessary or appropriate to the integration or simplification of the holding company system of which the transferor corporation is a member. If any such property so received is nonexempt property, gain shall be recognized unless such nonexempt property or an amount equal to the fair market value of such property at the time of the transfer is, within 24 months of the transfer, under regulations prescribed by the Commissioner with the approval of the Secretary, and in accordance with an order of the Securities and Exchange Commission, expended for property other than nonexempt property or is invested as a contribution to the capital, or as paid-in surplus, of another corporation, and such order recites that such expenditure or investment by the transferor corporation is necessary or appropriate to the integration or simplification of the holding company system of which the transferor corporation is a member. If the fair market value of such nonexempt property at the time of the transfer exceeds the amount expended and the amount invested, as required in the second sentence of this paragraph, the gain, if any, to the extent of such excess, shall be recognized. Any gain, to the extent that it cannot be applied in reduction of basis under section 372 (a) (2) shal be recognized. For the purposes of this subsection, a distribution in cancellation or redemption (except a distribution having the effect of a dividend) of the whole or a part of the transferor's own stock (not acquired on the transfer) and a payment in complete or partial retirement or cancellation of securities representing indebtedness of the transferor or a complete or partial retirement or cancellation of such securities which is a part of the consideration for the transfer, shall be considered an expenditure for property other than nonexempt property, and if, on the transfer, a liability of the transferor is assumed, or property of the transferor is transferred subject to a liability, the amount of such liability shall be considered to be an expenditure by the transferor for property other than nonexempt property. This subsection shall not apply unless the transferor corporation consents, at such time and in such manner as the Commissioner, with the approval of the Secretary, may by regulations prescribe, to the regulations prescribed under section 372 (a) (2) in effect at the time of filing its return for the taxable year in which the transfer occurs.

[NOTE: Prior to its amendment by sec. 171 (a), Rev. Act 1942, section 371 (b) read as follows: "*Exchanges of Property for Property by Corporations.* No gain or loss shall be recognized to a transferor corporation which is a registered holding company or an associate company of a registered holding company, if such corporation, in obedience to an order of the Securities and Exchange Commission transfers property solely in exchange for property (other than nonexempt property), and such order recites that such exchange by the transferor corporation is necessary or appropriate to the integration or simplification of the holding-company system of which the transferor corporation is a member."]

(c) *Distribution of stock or securities only.* If there is distributed, in obedience to an order of the Securities and Exchange Commission, to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company, stock or securities (other than stock or securities which are nonexempt property), without the surrender by such shareholder of stock or securities in such corporation, no gain to the distributee from the receipt of the stock or securities so distributed shall be recognized.

(d) *Transfers within system group.* (1) No gain or loss shall be recognized to a corporation which is a member of a system group (A) if such corporation transfers property to another corporation which is a member of the same system group in exchange for other property, and the exchange by each corporation is made in obedience to an order of the Securities and Exchange Commission, or (B) if there is distributed to such corporation as a shareholder in a corporation which is a member of the same system group, property, without the surrender by such shareholder of stock or securities in the corporation making the distribution, and the distribution is made and received in obedience to an order of the Securities and Exchange Commission. If an exchange by or a distribution to a corporation with respect to which no gain or loss is recognized under any of the provisions of this paragraph may also be considered to be within the provisions of subsection (a), (b), or (c), then the provisions of this paragraph only shall apply.

(2) If the property received upon an exchange which is within any of the provisions of paragraph (1) of this subsection consists in whole or in part of stock or securities issued by the corporation from which such property was received, and if in obedience to an order of the Securities and Exchange Commission such stock or securities (other than stock which is not preferred as to both dividends and assets) are sold and the proceeds derived therefrom are applied in whole or in part in the retirement or cancellation of stock or of securities of the recipient corporation outstanding at the time of such exchange, no gain or loss shall be recognized to the recipient corporation upon the sale of the stock or securities with respect to which such order was made; except that if any part of the proceeds derived from the sale of such stock or securities is not so applied, or if the amount of such proceeds is in excess of the fair market value of such stock or securities at the time of such exchange, the gain, if any, shall be recognized, but in an amount not in excess of the proceeds which are not so applied, or in an amount not more than the amount by which the proceeds derived from such sale exceed such fair market value, whichever is the greater.

(e) *Exchanges not solely in kind.* (1) If an exchange (not within any of the provisions of subsection (d)[1] would be within the provisions of subsection (a) if it were not for the fact that property received in exchange consists not only of property permitted by such subsection to be received without the recognition of gain or loss, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property, and the loss, if any, to the recipient shall not be recognized.

(2) If an exchange is within the provisions of paragraph (1) of this subsection and if it includes a distribution which has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under such paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under such paragraph (1) shall be taxed as a gain from the exchange of property.

(f) *Application of section.* The provisions of this section shall not apply to an exchange, expenditure, investment, distribution, or sale unless (1) the order of the Securities and Exchange Commission in obedience to which such exchange, expenditure, investment, distribution, or sale was made recites that such exchange, expenditure, investment, distribution, or sale is necessary or appropriate to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935, 49 Stat. 820 (U. S. C., title 15, sec. 79k (b)), (2) such order specifies and itemizes the stock and securities and other property which are ordered to be acquired, transferred, received, or sold upon such exchange, acquisition, expenditure, distribution, or sale, and, in the case of an investment, the investment to be made, and (3) of such exchange, acquisition, expenditure, investment, distribution or sale was made in obedience to such order, and was completed within the time prescribed therefor.

(g) *Non-application of other provisions.* If an exchange or distribution made in obedience to an order of the Securities and Exchange Commission is within any of the provisions of this section and may also be considered to be within any of the provisions of section 112 (other than the provisions of paragraph (8) of subsection (b)), then the provisions of this section only shall apply.

§ 29.371–0 *Terms used.* The following terms are defined in section 373 and when used in this section and §§ 29.371–1 to 29.373–1, inclusive, shall have the meanings therein assigned to them: "Order of the Securities and Exchange Commission"; "registered holding company"; "holding-company system"; "associate company"; "majority-owned subsidiary company"; "system group"; "nonexempt property"; and "stock or securities." Any other term used in this section and §§ 29.371–1 to 29.373–1, inclusive, which is defined in the Internal Revenue Code, shall be given the respective definition contained in the Code.

§ 29.371–1 *Purpose and scope of exception.* The general rule is that the entire amount of gain or loss from the sale or exchange of property is to be recognized (see section 112 (a)) and that the entire amount received as a dividend is to be included in gross income (see sections 22 (a) and 115). Exceptions to the general rule are provided in section 112, one of which is that made by section 112 (b) (8) with respect to exchanges, sales, and distributions specifically described in section 371. Section 371 provides the extent to which gain or loss is not to be recognized on an exchange or sale, or the receipt of a distribution, made in obedience to an order of the Securities and Exchange Commission, which is issued to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935. Section 115 (c) provides that a distribution in liquidation of a corporation shall be treated as an exchange, and such a distribution is to be so treated under the provisions of Supplement R (sections 371 to 373, inclusive). The order of the Securities and Exchange Commission must be one requiring or approving action which the Commission finds to be necessary or appropriate to effect a simplification or

[1] Closing parenthesis evidently intended.

geographical integration of a particular public utility holding-company system. For specific requirements with respect to an order of the Securities and Exchange Commission, see section 371 (f).

The requirements for nonrecognition of gain or loss as provided in section 371 are precisely stated with respect to the following four general types of transactions:

(a) The exchange that is provided for in section 371 (a), in which stock or securities in a registered holding company or a majority-owned subsidiary company are exchanged for stock or securities.

(b) The exchange that is provided for in section 371 (b), in which a registered holding company or an associate company of a registered holding company exchanges property for property.

(c) The distribution that is provided for in section 371 (c), in which stock or securities are distributed to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company.

(d) The transfer that is provided for in section 371 (d), in which a corporation which is a member of a system group transfers property to another member of the same system group.

Certain rules with respect to the receipt of nonexempt property on an exchange described in section 371 (a) are prescribed in section 371 (e).

These new exceptions to the general rule are to be strictly construed as in the case of the other exceptions in section 112. Unless both the purpose and the specific requirements of Supplement R (sections 371 to 373, inclusive) are clearly met, the recognition of gain or loss upon the exchange, sale, or distribution will not be postponed under Supplement R. Moreover, even though a taxable transaction occurs in connection or simultaneously with a realization of gain or loss to which nonrecognition is accorded, nevertheless, as under the various provisions of section 112, nonrecognition will not be accorded to such taxable transaction. In other words, the provisions of section 371 do not extend in any case to gain or loss other than that realized from and directly attributable to a disposition of property as such, or the receipt of a corporate distribution as such, in an exchange, sale, or distribution specifically described in section 371.

The application of the provisions of Supplement R (sections 371 to 373, inclusive) is intended to result only in postponing the recognition of gain or loss until a disposition of property is made which is not covered by such provisions, and, in the case of an exchange or sale subject to the provisions of section 371 (b), in the reduction of basis of certain property. The provisions of section 372 with respect to the continuation of basis and the reduction in basis are designed to effect these results. Although the time of recognition may be shifted, there must be a true reflection of income in all cases, and it is intended that the provisions of Supplement R shall not be construed or applied in such a way as to defeat this purpose.

§ 29.371–2 *Exchanges of stock or securities solely for stock or securities.* The exchange, without the recognition of gain or loss, that is provided for in section 371 (a) must be one in which stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary company are exchanged solely for stock or securities other than stock or securities which constitute nonexempt property. An exchange is not within the provisions of section 371 (a), unless the stock or securities transferred and those received are stock or securities as defined by section 373 (f). The stock or securities which may be received without the recognition of gain or loss are not limited to stock or securities in the corporation from which they are received. An exchange within the provisions of section 371 (a) may be a transaction between the holder of stock or securities and the corporation which issued the stock or securities. Also the exchange may be made by a holder of stock or securities with an associate company (i. e., a corporation in the same holding-company system with the issuing corporation) which is a registered holding company or a majority-owned subsidiary company. In either case, the nonrecognition provisions of section 371 (a) apply only to the holder of the stock or securities. However, the transferee corporation must be acting in obedience to an order of the Securities and Exchange Commission directed to such corporation, if no gain or loss is to be recognized to the holder of the stock or securities who makes the exchange with such corporation. See also section 371 (b), in case the holder of the stock or securities is a registered holding company or an associate company of a registered holding company. An exchange is not within the provisions of section 371 (a) if it is within the provisions of section 371 (d), relating to transfers within a system group. For further limitations, see section 371 (f).

§ 29.371–3 *Exchanges of property for property by corporations*—(a) *Application of section 371 (b).* Section 371 (b) applies only to the transfers specified therein with respect to which section 371 (d) is inapplicable, and deals only with such transfers if gain is realized upon the sale or other disposition effected by such transfers. If loss is realized the subsection is inapplicable and the application of other provisions of the Code must be determined. (See section 371 (g).) If section 371 (b) is applicable, the provisions of section 112 (other than the provisions of paragraph 8 of subsection (b)) are inapplicable, and the conditions under, and the extent to which, the realized gain is not recognized are set forth in paragraphs (b), (c), (d), and (e) of this section.

(b) *Nonrecognition of gain; no nonexempt proceeds.* No gain is recognized to a transferor corporation upon the sale or other disposition of property transferred by such transferor corporation in exchange solely for property other than nonexempt property, as defined in section 373 (e), but only if all of the following requirements are satisfied:

(1) The transferor corporation is, under the definition in section 373 (b), a registered holding company or an associate company of a registered holding company;

(2) Such transfer is in obedience to an order of the Securities and Exchange Commission (as defined in section 373 (a)) and such order satisfies the requirements of section 371 (f);

(3) The transferor corporation has filed the required consent to the regulations under section 372 (a) (2) (see subsection (f) of this section); and

(4) The entire amount of the gain, as determined under section 111, can be applied in reduction of basis under section 372 (a) (2).

(c) *Nonrecognition of gain; nonexempt proceeds.* If the transaction would be within the provisions of paragraph (b) of this section if it were not for the fact that the property received in exchange consists in whole or in part of nonexempt property (as defined in section 373 (e)), then no gain is recognized if such nonexempt property, or an amount equal to the fair market value of such nonexempt property at the time of the transfer,

(1) Is expended within the required 24-month period for property other than nonexempt property; or

(2) Is invested within the required 24-month period as a contribution to the capital, or as paid-in surplus, of another corporation;

but only if the expenditure or investment is made

(3) In accordance with an order of the Securities and Exchange Commission (as defined in section 373 (a)) which satisfies the requirements of section 371 (f) and which recites that such expenditure or investment by the transferor corporation is necessary or appropriate to the integration or simplification of the holding-company system of which the transferor corporation is a member; and

(4) The required consent, waiver, and bond have been executed and filed. See paragraphs (f) and (g) of this section.

The following, for the purposes of this paragraph and paragraph (d) of this section, are treated as expenditures for property other than nonexempt property:

(i) A distribution in cancellation or redemption (except a distribution having the effect of a dividend) of the whole or a part of the transferor's own stock (not acquired on the transfer);

(ii) A payment in complete or partial retirement or cancellation of securities representing indebtedness of the transferor or a complete or partial retirement or cancellation of such securities which is a part of the consideration for the transfer; and

(iii) If, on the transfer, a liability of the transferor is assumed, or property of the transferor is transferred subject to a liability, the amount of such liability.

(d) *Recognition of gain in part; insufficient expenditure or investment in case of nonexempt proceeds.* If the transaction would be within the provisions of paragraph (c) of this section if it were not for the fact that the amount ex-

pended or invested is less than the fair market value of the nonexempt property received in exchange, then the gain, if any, is recognized, but in an amount not in excess of the amount by which the fair market value of such nonexempt property at the time of the transfer exceeds the amount so expended and invested.

(e) *Recognition of gain in part; inability to reduce basis.* If the transaction would be within the provisions of paragraph (b) or (c) of this section if it were not for the fact that an amount of gain cannot be applied in reduction of basis under section 372 (a) (2), then the gain, if any, is recognized, but in an amount not in excess of the amount which cannot be so applied in reduction of basis. If the transaction would be within the provisions of paragraph (d) of this section, if it were not for the fact that an amount of gain cannot be applied in reduction of basis under section 372 (a) (2), then the gain, if any, is recognized but in an amount not in excess of the aggregate of:

(1) The amount of gain which would be recognized under paragraph (d) if there were no inability to reduce basis under section 372 (a) (2); and

(2) The amount of gain which cannot be applied in reduction of basis under section 372 (a) (2).

(f) *Consent to regulations under section 372 (a) (2).* To be entitled to the benefits of the provisions of section 371 (b), a corporation must file with its return for the taxable year in which the transfer occurred a consent to have the basis of its property adjusted under section 372 (a) (2) (see § 29.372–2), in accordance with the provisions of the regulations in effect at the time of filing of the return for the taxable year in which the transfer occurs. Such consent shall be made in duplicate on Form 982A in accordance with these regulations and the instructions on the form or issued therewith.

(g) *Requirements with respect to expenditure or investment.* If the full amount of the expenditure or investment required for the application of paragraph (c) of this section has not been made by the close of the taxable year in which such transfer occurred, the taxpayer shall file with the return for such year an application for the benefit of the 24-month period for expenditure and investment, reciting the nature and time of the proposed expenditure or investment. When requested by the Commissioner, the taxpayer shall execute and file (at such time and in such form) such waiver of the statute of limitations with respect to the assessment of deficiencies (for the taxable year of the transfer and for all succeeding taxable years in any of which falls any part of the period beginning with the date of the transfer and ending 24 months thereafter) as the Commissioner may specify, and such bond with such surety as the Commissioner may require in an amount not in excess of double the estimated maximum income and excess profits taxes which would be payable if the corporation does not make the required expenditure or investment within the required 24-month period.

§ 29.371–4 *Distribution solely of stock or securities.* If, without any surrender of his stock or securities as defined in section 373 (f), a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company receives stock or securities in such corporation or owned by such corporation, no gain to the shareholder will be recognized with respect to the stock or securities received by such shareholder which do not constitute nonexempt property, if the distribution to such shareholder is made by the distributing corporation in obedience to an order of the Securities and Exchange Commission directed to such corporation. A distribution is not within the provisions of section 371 (c) if it is within the provisions of section 371 (d), relating to transfers within a system group. A distribution is also not within the provisions of section 371 (c) if it involves a surrender by the shareholder of stock or securities or a transfer by the shareholder of property in exchange for the stock or securities received by the shareholder. For further limitations, see section 371 (f).

§ 29.371–5 *Transfers within system group.* The nonrecognition of gain or loss provided for in section 371 (d) 1 is applicable to an exchange of property for other property (including money and other nonexempt property). In order for any exchange to come within such section, all the parties to the exchange must be corporations which are members of the same system group. The term "system group" is defined in section 373 (d).

Section 371 (d) (1) also provides for nonrecognition of gain to a corporation which is a member of a system group if property (including money or other nonexempt property) is distributed to such corporation as a shareholder in a corporation which is a member of the same system group, without the surrender by such shareholder of stock or securities in the distributing corporation.

As stated in § 29.371–1, nonrecognition of gain or loss will not be accorded to a transaction not clearly provided for in Supplement R (sections 371 to 373, inclusive), even though such transaction occurs simultaneously or in connection with an exchange, sale, or distribution to which nonrecognition is specifically accorded. Therefore, nonrecognition will not be accorded to any gain or loss realized from the discharge, or the removal of the burden, of the pecuniary obligations of a member of a system group, even though such obligations are acquired upon a transfer or distribution specifically described in section 371 (d) (1); but the fact that the acquisition of such obligations was upon a transfer or distribution specifically described in section 371 (d) (1) will, because of the basis provisions of section 372 (d), affect the cost to the member of such discharge or its equivalent. Thus, section 371 (d) (1) does not provide for the nonrecognition of any gain or loss realized from the discharge of the indebtedness of a member of a system group as the result of the acquisition in exchange, sale, or distribution of its own bonds, notes, or other evidences of indebtedness which were acquired by another member of the same system group for a consideration less or more than the issuing price thereof (with proper adjustments for amortization of premiums or discounts).

Example. Suppose that the A Corporation and the B Corporation are both members of the same system group; that the A Corporation holds at a cost of $900 a bond issued by the B Corporation at par, $1,000; and that the A Corporation and the B Corporation enter into an exchange subject to the provisions of section 371 (d) (1) in which the $1,000 bond of the B Corporation is transferred from the A Corporation to the B Corporation. The $900 basis reflecting the cost to the A Corporation which would have been the basis available to the B Corporation if the property transferred to it had been something other than its own securities (see § 29.372–5) will, in this type of transaction, reflect the cost to the B Corporation of effecting a retirement of its own $1,000 bond. The $100 gain of the B Corporation reflected in the retirement will therefore be recognized.

No exchange or distribution may be made without the recognition of gain or loss as provided for in section 371 (d) (1), unless all the corporations which are parties to such exchange or distribution are acting in obedience to an order of the Securities and Exchange Commission. If an exchange or distribution is within the provisions of section 371 (d) (1) and also may be considered to be within some other provision of section 371, it shall be considered that only the provisions of section 371 (d) (1) apply and that the nonrecognition of gain or loss upon such exchange or distribution is by virtue of that section.

§ 29.371–6 *Sale of stock or securities received upon exchange by members of system group.* Section 371 (d) (2) provides that to the extent that property received upon an exchange by corporations which are members of the same system group consists of stock or securities issued by the corporation from which such property was received, such stock or securities may, under certain specifically described circumstances, be sold to a party not a member of the system group, without the recognition of gain or loss to the selling corporation. The nonrecognition of gain or loss is limited, in the case of stock, to a sale of stock which is preferred as to both dividends and assets. The stock or securities must have been received upon an exchange with respect to which section 371 (d) (1) operated to prevent recognition of gain or loss to any party to the exchange. Nonrecognition of gain or loss upon the sale of such stock or securities is permitted only if the proceeds derived from the sale are applied in retirement or cancellation of stock or securities of the selling corporation which were outstanding at the time the exchange was made. It is also essential to nonrecognition of gain or loss upon the sale that both the sale of the stock or securities and the application of the proceeds derived therefrom be made in obedience to an order of the Securities and Exchange Commission. If any part of the proceeds derived from the sale is not applied in making the required

retirement or cancellation of stock or securities and if the sale is otherwise within the provisions of section 371 (d) (2), the gain resulting from the sale shall be recognized, but in an amount not in excess of the proceeds which are not so applied. In any event, if the proceeds derived from the sale of the stock or securities exceed the fair market value of such stock or securities at the time of the exchange through which they were acquired by the selling corporation, the gain resulting from the sale is to be recognized to the extent of such excess. Section 371 (d) (2) does not provide for the nonrecognition of any gain resulting from the retirement of bonds, notes, or other evidences of indebtedness for a consideration less than the issuing price thereof. Also, that section does not provide for the nonrecognition of gain or loss upon the sale of any stock or securities received upon a distribution or otherwise than upon an exchange.

Example. The X Corporation and the Y Corporation, both of which make their income tax returns on a calendar year basis, are members of the same system group. As part of an exchange in which section 371 (d) (1) is applicable the Y Corporation on June 1, 1942, issues to the X Corporation 1,000 shares of class A stock, preferred as to both dividends and assets. The fair market value of such stock at the time of issuance is $90,000 and its basis to the X Corporation is $75,000. On December 1, 1942, in obedience to an appropriate order of the Securities and Exchange Commission, the X Corporation sells all of such stock to the public for $100,000 and applies $95,000 of this amount to the retirement of its own bonds, which were outstanding on June 1, 1942. The remaining $5,000 is not used to retire any of the X Corporation's stock or securties. Of the total gain of $25,000 realized on the disposition of the Y Corporation stock only $10,000 is recognized, being the difference between the fair market value of the stock when acquired and the amount for which it was sold, since such amount is greater than the portion ($5,000) of the proceeds not applied to the retirement of the X Corporation's stock or securities.

If in the above example the stock acquired by the X Corporation had not been stock of the Y Corporation issued to the X Corporation or if it had been stock not preferred as to both dividends and assets, the full amount of the gain ($25,000) realized upon its disposition would have been recognized, regardless of what was done with the proceeds.

§ 29.371–7 *Exchanges in which money or other nonexempt property is received.* Under section 371 (e) (1), if in any exchange (not within any of the provisions of section 371 (d)) in which stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary are exchanged for stock or securities as provided for in section 371 (a), there is received by the taxpayer money or other nonexempt property (in addition to property permitted to be received without recognition of gain), then:

(a) The gain, if any, to the taxpayer is to be recognized in an amount not in excess of the sum of the money and the fair market value of the other nonexempt property, but

(b) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent.

If money or other nonexempt property is received from a corporation in an exchange described in this section and if the distribution of such money or other nonexempt property by or on behalf of such corporation has the effect of the distribution of a taxable dividend, then, as provided in section 371 (e) (2), there shall be taxed to each distributee (1) as a dividend, such an amount of the gain recognized on the exchange as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) the remainder of the gain so recognized shall be taxed as a gain from the exchange of property.

§ 29.371–8 *Requirements with respect to order of securities and exchange commission.* The term "order of the Securities and Exchange Commission" is defined in section 373 (a). In addition to the requirements specified in that definition, section 371 (f) provides that the provisions of section 371 shall not apply to an exchange, expenditure, investment, distribution, or sale unless each of the following requirements is met:

(a) The order of the Securities and Exchange Commission must recite that the exchange, expenditure, investment, distribution, or sale is necessary or appropriate to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935.

(b) The order shall specify and itemize the stocks and securities and other property (including money) which are ordered to be acquired, transferred, received, or sold upon such exchange, acquisition, expenditure, distribution, or sale, and, in the case of an investment, the investment to be made, so as clearly to identify such property.

(c) The exchange acquisition, expenditure, investment, distribution, or sale shall be made in obedience to such order and shall be completed within the time prescribed in such order.

These requirements were not designed merely to simplify the administration of the provisions of section 371, and they are not to be considered as pertaining only to administrative matters. Each one of the three requirements is of the essence, and must be met if gain or loss is not to be recognized upon the transaction.

§ 29.371–9 *Nonapplication of other provisions of the Internal Revenue Code.* The effect of section 371 (g) is that an exchange, sale, or distribution which is within section 371 shall, with respect to the nonrecognition of gain or loss and the determination of basis, be governed only by Supplement R (sections 371 to 373, inclusive), the purpose being to prevent overlapping of the provisions of such supplement and other provisions of the Internal Revenue Code. In other words, if by virtue of section 371 any portion of a person's gain or loss on any particular exchange, sale, or distribution is not to be recognized, then the gain or loss of such person shall be nonrecognized only to the extent provided in section 371, regardless of what the result might have been under section 112 if Supplement R had not been enacted; and similarly, the basis in the hands of such person of the property received by him in such transaction shall be the basis provided by section 372, regardless of what the basis of such property might have been under section 113 if Supplement R had not been enacted. On the other hand, if section 371 does not provide for the nonrecognition of any portion of a person's gain or loss (whether or not such person is another party to the same transaction referred to above), then the gain or loss of such person shall be recognized or nonrecognized to the extent provided for by other provisions of the Code as if Supplement R had not been enacted; and similarly, the basis in his hands of the property received by him in such transaction shall be the basis provided by other provisions of the Code as if Supplement R had not been enacted.

§ 29.371–10 *Records to be kept and information to be filed with returns.* (a) Every holder of stock or securities who receives stock or securities and other property (including money) upon an exchange shall, if the exchange is made with a corporation acting in obedience to an order of the Securities and Exchange Commission, file as a part of his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including:

(1) A clear description of the stock or securities transferred in the exchange, together with a statement of the cost or other basis of such stock or securities.

(2) The name and address of the corporation from which the stock or securities were received in the exchange.

(3) A statement of the amount of stock or securities and other property (including money) received from the exchange. The amount of each kind of stock or securities and other property received shall be set forth upon the basis of the fair market value thereof at the date of the exchange.

(b) Each corporation which is a party to an exchange made in obedience to an order of the Securities and Exchange Commission directed to such corporation shall file as a part of its income tax return for its taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including:

(1) A copy of the order of the Securities and Exchange Commission directed to such corporation, in obedience to which the exchange was made.

(2) A certified copy of the corporate resolution authorizing the exchange.

(3) A clear description of all property, including all stock or securities, transferred in the exchange, together with a complete statement of the cost or other basis of each class of property.

(4) The date of acquisition of any stock or securities transferred in the exchange, and, if any of such stock or securities were acquired by the corporation in obedience to an order of the Securities and Exchange Commission, a copy of such order.

(5) The name and address of all persons to whom any property was transferred in the exchange.

(6) If any property transferred in the exchange was transferred to another corporation, a copy of any order of the Securities and Exchange Commission directed to the other corporation, in obedience to which the exchange was made by such other corporation.

(7) If the corporation transfers any nonexempt property, the amount of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, to the time of the exchange.

(8) A statement of the amount of stock or securities and other property (including money) received upon the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities and other property received shall be stated on the basis of the fair market value thereof at the date of the exchange.

(9) A statement showing as to each class of its stock the number of shares and percentage owned by any other corporation, the voting rights and voting power, and the preference (if any) as to both dividends and assets.

(10) The term "exchange" shall, wherever occurring in this subsection (other than this paragraph), be read as "exchange, expenditure, or investment."

(c) Each shareholder who receives stock or securities or other property (including money) upon a distribution made by a corporation in obedience to an order of the Securities and Exchange Commission shall file as a part of his income tax return for the taxable year in which such distribution is received a complete statement of all facts pertinent to the nonrecognition of gain upon such distribution, including:

(1) The name and address of the corporation from which the distribution is received.

(2) A statement of the amount of stock or securities or other property received upon the distribution, including (in case the shareholder is a corporation) a statement of all distributions or other disposition made of such stock or securities or other property by the shareholder. The amount of each class of stock or securities and each kind of property shall be stated on the basis of the fair market value thereof at the date of the distribution.

(3) If the shareholder is a corporation, a statement showing as to each class of its stock the number of shares and percentage owned by a registered holding company or a majority-owned subsidiary company of a registered holding company, the voting rights and voting power, and the preference (if any) as to both dividends and assets.

(d) Every corporation making a distribution in obedience to an order of the Securities and Exchange Commission shall file as a part of its income tax return for its taxable year in which the distribution is made a complete statement of all facts pertinent to the nonrecognition of gain to the distributee upon such distribution including:

(1) A copy of the order of the Securities and Exchange Commission, in obedience to which the distribution was made.

(2) A certified copy of the corporate resolution authorizing the distribution.

(3) A statement of the amount of stock or securities or other property (including money) distributed to each shareholder. The amount of each kind of stock or securities or other property shall be stated on the basis of the fair market value thereof at the date of the distribution.

(4) The date of acquisition of the stock or securities distributed, and, if any of such stock or securities were acquired by the distributing corporation in obedience to an order of the Securities and Exchange Commission, a copy of such order.

(5) The amount of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, to the time of the distribution.

(6) A statement showing as to each class of its stock the number of shares and percentage owned by any other corporation, the voting rights and voting power, and the preference (if any) as to both dividends and assets.

(e) Each corporation which is a member of a system group and which in obedience to an order of the Securities and Exchange Commission sells stock or securities received upon an exchange (made in obedience to an order of the Securities and Exchange Commission) and applies the proceeds derived therefrom in retirement or cancellation of its own stock or securities shall file as a part of its income tax return for the taxable year in which the sale is made a complete statement of all facts pertaining to the nonrecognition of gain or loss upon such sale, including:

(1) A copy of the order of the Securities and Exchange Commission in obedience to which the sale was made.

(2) A copy of the order of the Securities and Exchange Commission in obedience to which the proceeds derived from the sale were applied in whole or in part in the retirement or cancellation of its stock or securities.

(3) A certified copy of the corporate resolutions authorizing the sale of the stock or securities and the application of the proceeds derived therefrom.

(4) A clear description of the stock or securities sold, including the name and address of the corporation by which they were issued.

(5) The date of acquisition of the stock or securities sold, together with a statement of the fair market value of such stock or securities at the date of acquisition, and a copy of all orders of the Securities and Exchange Commission in obedience to which such stock or securities were acquired.

(6) The amount of the proceeds derived from such sale.

(7) The portion of the proceeds of such sale which was applied in retirement or cancellation of its stock or securities, together with a statement showing how long such stock or securities were outstanding prior to retirement or cancellation.

(8) The issuing price of its stock or securities which were retired or canceled.

(f) Permanent records in substantial form shall be kept by every taxpayer who participates in an exchange or distribution made in obedience to an order of the Securities and Exchange Commission, showing the cost or other basis of the property transferred and the amount of stock or securities and other property (including money) received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received on the exchange or distribution.

SEC. 372. BASIS FOR DETERMINING GAIN OR LOSS [as amended by sec. 171 (c), Rev. Act 1942].

(a) *Exchanges generally*—(1) *Exchanges subject to the provisions of section 371 (a).* If the property was acquired upon an exchange subject to the provisions of section 371 (a) or (e), the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 371 (a) to be received without the recognition of gain or loss, and in part of nonexempt property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such nonexempt property (other than money) an amount equivalent to its fair market value at the date of the exchange. This subsection shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

(2) *Exchanges subject to the provisions of section 371 (b).* The gain not recognized upon a transfer by reason of section 371 (b) shall be applied to reduce the basis for determining gain or loss on sale or exchange of the following categories of property in the hands of the transferor immediately after the transfer, and property acquired within 24 months after such transfer by an expenditure or investment to which section 371 (b) relates on account of the acquisition of which gain is not recognized under such subsection, in the following order:

(1) Property of a character subject to the allowance for depreciation under section 23 (l);

(2) Property (not described in paragraph (1)) with respect to which a deduction for amortization is allowable under section 23 (t);

(3) Property with respect to which a deduction for depletion is allowable under section 23 (m) but not allowable under section 114 (b) (2), (3), or (4);

(4) Stock and securities of corporations not members of the system group of which the transferor is a member (other than stock or securities of a corporation of which the transferor is a subsidiary);

(5) Securities (other than stock) of corporations which are members of the system group of which the transferor is a member (other than securities of the transferor or of a corporation of which the transferor is a subsidiary);

(6) Stock of corporations which are members of the system group of which the transferor is a member (other than stock of the transferor or of a corporation of which the transferor is a subsidiary);

(7) All other remaining property of the transferor (other than stock or securities of the transferor or of a corporation of which the transferor is a subsidiary).

The manner and amount of the reduction to be applied to particular property within any of the categories described in paragraphs (1) to (7), inclusive, shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. [NOTE: Prior to its amendment by sec. 171 (c), Rev. Act 1942, section 372 (a) read as follows: "(a) *Exchanges generally.* If the property was acquired upon an exchange subject to the provisions of section 371 (a), (b), or (e), the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 371 (a) or (b) to be received without the recognition of gain or loss, and in part of nonexempt property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such nonexempt property (other than money) an amount equivalent to its fair market value at the date of the exchange. This subsection shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it."]

(b) *Transfers to corporations.* If, in connection with a transfer subject to the provisions of section 371 (a), (b), or (e), the property was acquired by a corporation, either as paid-in surplus or as a contribution to capital, or in consideration for stock or securities issued by the corporation receiving the property (including cases where part of the consideration for the transfer of such property to the corporation consisted of property or money in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

(c) *Distributions of stock or securities.* If the stock or securities were received in a distribution subject to the provisions of section 371 (c), then the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed.

(d) *Transfers within system group.* If the property was acquired by a corporation which is a member of a system group upon a transfer or distribution described in section 371 (d) (1), then the basis shall be the same as it would be in the hands of the transferor; except that if such property is stock or securities issued by the corporation from which such stock or securities were received and they were issued (1) as the sole consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either (A) the same as in the case of the property transferred therefor, or (B) the fair market value of such stock or securities at the time of their receipt, whichever is the lower; or (2) as part consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either (A) an amount which bears the same ratio to the basis of the property transferred as the fair market value of such stock or securities at the time of their receipt bears to the total fair market value of the entire consideration received, or (B) the fair market value of such stock or securities at the time of their receipt, whichever is the lower.

§ 29.372–0 *Basis for determining gain or loss.* Section 113 (a) (17) provides that if property is acquired in a taxable year beginning before January 1, 1942, in any manner described in section 372, prior to its amendment by the Revenue Act of 1942, the basis shall be that provided in such section, prior to its amendment by such Act, with respect to such property. If the property was acquired in a taxable year beginning after December 31, 1941, in any manner described in section 372 (other than subsection (a) (2)) after its amendment by such Act, the basis shall be that prescribed in such section (after its amendment by such Act) with respect to such property. Section 372 therefore expands section 113 (a) in order to make adequate provisions with respect to the basis of property acquired in a transfer made in obedience to an order of the Securities and Exchange Commission in connection with which the recognition of gain or loss is prohibited by the provisions of section 112 (b) (8) and section 371 with respect to the whole or any part of the property received. In general and except as provided in § 29.372–2, it is intended that the basis for determining gain or loss pertaining to the property prior to its transfer, as well as the basis for determining the amount of depreciation or depletion deductible and the amount of earnings or profits available for distribution, shall continue notwithstanding the nontaxable conversion of the asset in form or its change in ownership. The continuance of the basis may be reflected in a shift thereof from one asset to another in the hands of the same owner, or in its transfer with the property from one owner into the hands of another. See also § 29.371–1.

§ 29.372–1 *Basis of property acquired upon exchanges under section 371 (a), 371 (b) (prior to amendment by the Revenue Act of 1942), or 371 (e).* In the case of an exchange of stock or securities for stock or securities as described in section 371 (a), or an exchange of property for property as described in section 371 (b), prior to its amendment by the Revenue Act of 1942 and in a taxable year beginning prior to January 1, 1942, if no part of the gain or loss upon such exchange was recognized under section 371, the basis of the property acquired is the same as the basis of the property transferred by the taxpayer with proper adjustments to the date of the exchange.

If, in an exchange of stock or securities as described in section 371 (a), or in an exchange of property for property as described in section 371 (b), prior to its amendment by the Revenue Act of 1942 and in a taxable year beginning prior to January 1, 1942, gain to the taxpayer was recognized under section 371 (e), on account of the receipt of money, the basis of the property acquired is the basis of the property transferred (adjusted to the date of the exchange), decreased by the amount of money received and increased by the amount of gain recognized upon the exchange. If, upon such exchange, there were received by the taxpayer money and other nonexempt property (not permitted to be received without the recognition of gain), and gain from the transaction was recognized under section 371 (e), the basis (adjusted to the date of the exchange) of the property transferred by the taxpayer, decreased by the amount of money received and increased by the amount of gain recognized, must be apportioned to and is the basis of the properties (other than money) received on the exchange. For the purpose of the allocation of such basis to the properties received, there must be assigned to the nonexempt property (other than money) an amount equivalent to its fair market value at the date of the exchange.

Section 371 (e) provides that no loss may be recognized on an exchange of stock or securities for stock or securities as described in section 371 (a), or on an exchange of property for property as described in section 371 (b), prior to its amendment by the Revenue Act of 1942 and in a taxable year beginning prior to January 1, 1942, although the taxpayer receives money or other nonexempt property from the transaction. However, the basis of the property (other than money) received by the taxpayer is the basis (adjusted to the date of the exchange) of the property transferred, decreased by the amount of money received. This basis must be apportioned to the properties received, and for this purpose there must be allocated to the nonexempt property (other than money) an amount of such basis equivalent to the fair market value of such nonexempt property at the date of the exchange.

Section 372 (a) does not apply in ascertaining the basis of property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it. For the rule in such cases, see section 372 (b).

§ 29.372–2 *Reduction of basis of property by reason of gain not recognized under section 371 (b)—(a) Introductory.* In addition to the adjustments provided in section 113 (b), and the sections of these regulations relating thereto, which are required to be made with respect to the cost or other basis of property, section 372 (a) (2) provides that a further adjustment shall be made in any case in which there shall have been a nonrecognition of gain under section 371 (b), realized in a taxable year beginning after December 31, 1941. Such further adjustment shall be made with respect to the basis of the property in the hands of the transferor immediately after the transfer and of the property acquired within 24 months after such transfer by an expenditure or investment to which section 371 (b) relates, and on account of which expenditure or investment gain is not recognized. If the property is in

the hands of the transferor immediately after the transfer, the time of reduction is the day of the transfer; in all other cases the time of reduction is the date of acquisition. The effect of applying an amount in reduction of basis of property under such subsection is to reduce by such amount the basis for determining gain upon sale or other disposition, the basis for determining loss upon sale or other disposition, the basis for depreciation and for depletion, and any other amount which the Internal Revenue Code prescribes shall be the same as any of such bases. For the purposes of the application of an amount in reduction of basis under such subsection, property is not considered as having a basis capable of reduction if:

(1) It is money, or

(2) If its adjusted basis for determining gain at the time the reduction is to be made is zero, or becomes zero at any time in the application of such subsection.

(b) *General rule.* Section 372 (a) (2) sets forth seven categories of property, the basis of which for determining gain or loss shall be reduced in the order stated.

The first category consists of all property of a character subject to the allowance for depreciation under section 23 (l) which is either in the hands of the transferor immediately after the transfer, or is acquired within 24 months after such transfer by an expenditure or investment resulting in the nonrecognition in whole or in part of gain, under section 371 (b). If any of the property in such category has a basis capable of reduction, the reduction must first be made before applying an amount in reduction of the basis of any property in the second or in a succeeding category, to each of which in turn a similar rule is applied.

In the application of the rule to each category, the amount of the gain not recognized shall be applied to reduce the cost or other basis of all the property in the category as follows: The cost or other basis (at the time immediately after the transfer or, if the property is not then held but is thereafter acquired, at the time of such acquisition) of each unit of property in the first category shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis at such time for determining gain, determined without regard to this section) in an amount equal to such proportion of the unrecognized gain as the adjusted basis (for determining gain, determined without regard to this section) at such time of each unit of property of the taxpayer in that category bears to the aggregate of the adjusted basis (for determining gain, computed without regard to this section) at such time of all the property of the taxpayer in that category. When such adjusted basis of the property in the first category has been thus reduced to zero, a similar rule shall be applied, with respect to the portion of such gain which is unabsorbed in such reduction of the basis of the property in such category, in reducing the basis of the property in the second category. A similar rule with respect to the remaining unabsorbed gain shall be applied in reducing the basis of the property in the next succeeding category.

(c) *Special cases.* With the consent of the Commissioner, the taxpayer may, however, have the basis of the various units of property within a particular category specified in section 372 (a) (2) adjusted in a manner different from the general rule set forth in paragraph (b) of this section. Variations from such general rule may, for example, involve adjusting the basis of only certain units of the taxpayer's property within a given category. A request for variations from the general rule should be filed by the taxpayer with its return for the taxable year in which the transfer of property has occurred.

Agreement between the taxpayer and the Commissioner as to any variations from such general rule shall be effective only if incorporated in a closing agreement entered into under the provisions of section 3760. If no such agreement is entered into by the taxpayer and the Commissioner, then the consent filed on Form 982A shall (except as provided in the next sentence) be deemed to be a consent to the application of such general rule, and such general rule shall apply in the determination of the basis of the taxpayer's property. If, however, the taxpayer specifically states on such form that it does not consent to the application of the general rule, then, in the absence of a closing agreement, the document filed shall not be deemed a consent within the meaning of the last sentence of section 371 (b).

§ 29.372–3 *Basis of property acquired by corporation under section 371 (a), 371 (b), or 371 (e) as contribution of capital or surplus, or in consideration for its own stock or securities.* If, in connection with an exchange of stock or securities for stock or securities as described in section 371 (a), or an exchange of property for property as described in section 371 (b), or an exchange as described in section 371 (e), property is acquired by a corporation by the issuance of its stock or securities, the basis of such property shall be determined under section 372 (b). If the corporation issued its stock or securities as part or sole consideration for the property acquired, the basis of the property in the hands of the acquiring corporation is the basis (adjusted to the date of the exchange) which the property would have had in the hands of the transferor if the transfer had not been made, increased in the amount of gain or decreased in the amount of loss recognized under section 371 to the transferor upon the transfer. If any property is acquired by a corporation from a shareholder as paid-in surplus, or from any person as a contribution to capital, the basis of the property to the corporation is the basis (adjusted to the date of acquisition) of the property in the hands of the transferor.

§ 29.372–4 *Basis of stock or securities acquired by shareholder upon tax-free distribution under section 371 (c).* Under section 372 (c), if there was distributed to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company stock or securities (other than stock or securities which are nonexempt property), and if by virtue of section 371 (c) no gain was recognized to the shareholder upon such distribution, then the basis of the stock in respect of which the distribution was made must be apportioned between such stock and the stock or securities so distributed to the shareholder. The basis of the old shares and the stock or securities received upon the distribution shall be determined in accordance with the following rules:

(a) If the stock or securities received upon the distribution consist solely of stock in the distributing corporation and the stock received is all of substantially the same character and preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and the new shares.

(b) If the stock or securities received upon the distribution are in whole or in part stock in a corporation other than the distributing corporation, or are in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or if the distribution consists in whole or in part of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security to which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provisions stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class. As to the basis of stock or securities distributed by one member of a system group to another member of the same system group, see section 372 (d).

§ 29.372–5 *Basis of property acquired under section 371 (d) in transactions between corporations of the same system group.* If property was acquired by a corporation which is a member of a system group, from a corporation which is a member of the same system group, upon a transfer or distribution described in section 371 (d) (1), then as a general rule the basis of such property in the hands of the acquiring corporation is the basis which such property would have had in the hands of the transferor if the transfer or distribution had not been made.

Except as otherwise indicated in this section, this rule will apply equally to

cases in which the consideration for the property acquired consists of stock or securities, money, and other property, or any of them, but it is contemplated that an ultimate true reflection of income will be obtained in all cases, notwithstanding any peculiarities in form which the various transactions may assume. See the example in § 29.371–5.

An exception to this general rule is provided for in case the property acquired consists of stocks or securities issued by the corporation from which such stock or securities were received. If such stock or securities were the sole consideration for the property transferred to the corporation issuing such stock or securities, then the basis of the stock or securities shall be (1) the same as the basis (adjusted to the time of the transfer) of the property transferred for such stock or securities, or (2) the fair market value of such stock or securities at the time of their receipt, whichever is the lower. If such stock or securities constituted only part consideration for the property transferred to the corporation issuing such stock or securities, then the basis shall be an amount which bears the same ratio to the basis of the property transferred as the fair market value of such stock or securities on their receipt bears to the total fair market value of the entire consideration received, except that the fair market value of such stock or securities at the time of their receipt shall be the basis therefor, if such value is lower than such amount.

Example. Suppose the A Corporation has property with an adjusted basis of $600,000 and in an exchange in which section 371 (d) (1) is applicable, transfers such property to the B Corporation in exchange for a total consideration of $1,000,000, consisting of (1) cash in the amount of $100,000, (2) tangible property having a fair market value of $400,000 and an adjusted basis in the hands of the B Corporation of $300,000, and (3) stock or securities issued by the B Corporation with a par value and fair market value as of the date of their receipt in the amount of $500,000. The basis to the B Corporation of the property received by it is $600,000, which is the adjusted basis of such property in the hands of the A Corporation. The basis to the A Corporation of the assets (other than cash) received by it is as follows: Tangible property, $300,000, the adjusted basis of such property to the B Corporation, the former owner; stock or securities issued by the B Corporation, $300,000, an amount equal to 500,000/1,000,000ths of $600,000.

Suppose that the property of the A Corporation transferred to the B Corporation had an adjusted basis of $1,100,000 instead of $600,000, and that all other factors in the illustration in the preceding paragraph remain the same. In such case the basis to the A Corporation of the stock or securities in the B Corporation is $500,000, which was the fair market value of such stock or securities at the time of their receipt by the A Corporation, and not the amount established as 500,000/1,000,000ths of $1,100,000, or $550,000.

SEC. 373. DEFINITIONS [as amended by sec. 221 (a), Rev. Act 1939, sec. 117 (a), Rev. Act 1941; sec. 171 (d) (e) (f), Rev. Act 1942].

As used in this supplement—

(a) The term "order of the Securities and Exchange Commission" means an order issued after May 28, 1938, by the Securities and Exchange Commission which requires, authorizes, permits, or approves transactions described in such order to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935, 49 Stat. 820 (U.S.C., title 15, sec. 79k (b)), which has become or becomes final in accordance with law.

(b) The terms "registered holding company", "holding-company system", and "associate company" shall have the meanings assigned to them by section 2 of the Public Utility Holding Company Act of 1935, 49 Stat. 804 (U.S.C., Supp. III, title 15, § 79 (b), (c).

(c) The term "majority-owned subsidiary company" of a registered holding company means a corporation, stock of which, representing in the aggregate more than 50 per centum of the total combined voting power of all classes of stock of such corporation entitled to vote (not including stock which is entitled to vote only upon default or nonpayment of dividends or other special circumstances) is owned wholly by such registered holding company, or partly by such registered holding company and partly by one or more majority-owned subsidiary companies thereof, or by one or more majority-owned subsidiary companies of such registered holding company.

(d) The term "system group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 90 per centum of each class of the stock (other than stock which is preferred as to both dividends and assets) of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 90 per centum of each class of the stock (other than stock which is preferred as to both dividends and assets) of at least one of the other corporations; and

(3) Each of the corporations is either a registered holding company or a majority-owned subsidiary company.

(e) The term "nonexempt property" means—

(1) Any consideration in the form of evidences of indebtedness owed by the transferor or a cancellation or assumption of debts or other liabilities of the transferor (including a continuance of encumbrances subject to which the property was transferred);

(2) Short-term obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding twenty-four months, exclusive of days of grace;

(3) Securities issued or guaranteed as to principal or interest by a government or subdivision thereof (including those issued by a corporation which is an instrumentality of a government or subdivision thereof);

(4) Stock or securities which were acquired from a registered holding company or an associate company of a registered holding company which acquired such stock or securities after February 28, 1938, unless such stock or securities (other than obligations described as nonexempt property in paragraph (1), (2), or (3)) were acquired in obedience to an order of the Securities and Exchange Commission or were acquired with the authorization or approval of the Securities and Exchange Commission under any section of the Public Utility Holding Company Act of 1935, 49 Stat. 820 (U.S.C., title 15, sec. 79k (b));

(5) Money, and the right to receive money not evidenced by a security other than an obligation described as nonexempt property in paragraph (2) or (3).

(f) The term "stock or securities" means shares of stock in any corporation, certificates of stock or interest in any corporation, notes, bonds, debentures, and evidences of indebtedness (including any evidence of an interest in or right to subscribe to or purchase any of the foregoing).

§ 29.373–1 *Definitions*—(a) *"Order of the Securities and Exchange Commission."* An order of the Securities and Exchange Commission as defined in section 373 (a) must be issued after May 28, 1938 (the date of the enactment of the Revenue Act of 1938), and must be issued under the authority of section 11 (b) or 11 (e) of the Public Utility Holding Company Act of 1935 to effectuate the provisions of section 11 (b) of such Act. In all cases the order must become or have become final in accordance with law; i. e., it must be valid, outstanding, and not subject to further appeal. See further sections 373 (a) and 371 (f). Section 11 (b) of the Public Utility Holding Company Act of 1935 provides:

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness or regulation.

The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more intergrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding com-

pany. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

Section 11 (e) of the Public Utility Holding Company Act of 1935 provides:

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

(b) *"Registered holding company," "holding-company system," and "associate company."* Under section 5 of the Public Utility Holding Company Act of 1935 any holding company may register by filing with the Securities and Exchange Commission a notification of registration, in such form as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers. A holding company shall be deemed to be registered upon receipt by the Securities and Exchange Commission of such notification of registration. The term "registered holding company" as used in these regulations means a holding company whose notification of registration has been so received and whose registration is still in effect under section 5 of the Public Utility Holding Company Act of 1935. Under section 2 (a) (7) of the Public Utility Holding Company Act of 1935, a corporation is a holding company (unless it is declared not to be such by the Securities and Exchange Commission), if such corporation directly or indirectly owns, controls, or holds with power to vote 10 percent or more of the outstanding voting securities of a public-utility company (i. e., an electric utility company or a gas utility company as defined by such Act) or of any other holding company. A corporation is also a holding company if the Securities and Exchange Commission determines, after notice and opportunity for hearing, that such corporation directly or indirectly exercises (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility company (i. e., an electric utility company or a gas utility company as defined by such Act) or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such corporation be subject to the obligations, duties, and liabilities imposed upon holding companies by the Public Utility Holding Company Act of 1935. An electric utility company is defined by section 2 (a) (3) of the Public Utility Holding Company Act of 1935 to mean a company which owns or operates facilities used for the generation, transmission, or distribution of electrical energy for sale, other than sale to tenants or employees of the company operating such facilities for their own use and not for resale; and a gas utility company is defined by section 2 (a) (4) of such Act to mean a company which owns or operates facilities used for the distribution at retail (other than distribution only in enclosed portable containers, or distribution to tenants or employees of the company operating such facilities for their own use and not for resale) of natural or manufactured gas for heat, light, or power. However, under certain conditions the Securities and Exchange Commission may declare a company not to be an electric utility company or a gas utility company, as the case may be, in which event the company, shall not be considered an electric utility company or a gas utility company.

The term "holding-company system" has the meaning assigned to it by section 2 (a) (9) of the Public Utility Holding Company Act of 1935, and hence means any holding company, together with all its subsidiary companies (i. e., subsidiary companies within the meaning of section 2 (a) (8) of such Act, which in general include all companies 10 percent of whose outstanding voting securities is owned directly or indirectly by such holding company) and all mutual service companies of which such holding company or any subsidiary company thereof is a member company. The term "mutual service company" means a company approved as a mutual service company under section 13 of the Public Utility Holding Company Act of 1935. The term "member company" is defined by section 2 (a) (14) of such Act to mean a company which is a member of an association or group of companies mutually served by a mutual service company.

The term "associate company" has the meaning assigned to it by section 2 (a) (10) of the Public Utility Holding Company Act of 1935, and hence an associate company of a company is any company in the same holding-company system with such company.

(c) *"Majority-owned subsidiary company."* The term "majority-owned subsidiary company" is defined in section 373 (c). Direct ownership by a registered holding company of more than 50 percent of the specified stock of another corporation is not necessary to constitute such corporation a majority-owned subsidiary company. To illustrate, if the H Corporation, a registered holding company, owns 51 percent of the common stock of the A Corporation and 31 percent of the common stock of the B Corporation, and the A Corporation owns 20 percent of the common stock of the B Corporation (the common stock in each case being the only stock entitled to vote), both the A Corporation and the B Corporation are majority-owned subsidiary companies.

(d) *"System group."* The term "system group" is defined in section 373 (d) to mean one or more chains of corporations connected through stock ownership with a common parent corporation, if at least 90 percent of each class of stock (other than stock preferred as to both dividends and assets) of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations and the common parent corporation owns directly at least 90 percent of each class of such stock of at least one of the other corporations; but no corporation is a member of a system group if it is not either a registered holding company or a majority-owned subsidiary company. It is to be observed that while the type of stock which must be at least 90 percent owned for the purpose of this definition (i. e., stock not preferred as to both dividends and assets) may be different from the voting stock which must be more than 50 percent owned for the purpose of the definition of a majority-owned subsidiary company under section 373 (c), yet as a general rule both types of ownership tests must be met under section 373 (d), since a corporation, in order to be a member of a system group, must also be a registered holding company or a majority-owned subsidiary company.

(e) *"Nonexempt property."* The term "nonexempt property" is defined by section 373 (e) to include:

(1) The amount of any consideration in the form of a cancellation or assump-

tion of debts or other liabilities (including a continuance of encumbrances subject to which the property was transferred and including the amount of any consideration in the form of evidences of indebtedness owned by the transferor). To illustrate, if in obedience to an order of the Securities and Exchange Commission the X Corporation, a registered holding company, transfers property to the Y Corporation in exchange for property (not nonexempt property) with a fair market value of $500,000, the X Corporation receives $100,000 of nonexempt property, if for example:

(i) The Y Corporation cancels $100,000 of indebtedness owed to it by the X Corporation;

(ii) The Y Corporation assumes an indebtedness of $100,000 owed by the X Corporation to another company, the A Corporation; or

(iii) The Y Corporation takes over the property conveyed to it by the X Corporation subject to a mortgage of $100,000.

(2) Short-term obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace.

(3) Securities issued or guaranteed as to principal or interest by a government or subdivision thereof (including those issued by a corporation which is an instrumentality of a government of subdivision thereof).

(4) Stock or securities which are acquired from a registered holding company which acquired such stock or securities after February 28, 1938, or an associate company of a registered holding company which acquired such stock or securities after February 28, 1938, unless such stock or securities were acquired in obedience to an order of the Securities and Exchange Commission (as defined in section 373 (a), as amended) or were acquired with the authorization or approval of the Securities and Exchange Commission under any section of the Public Utility Holding Company Act of 1935, and are not nonexempt property within the meaning of section 373 (e) (1), (2), or (3).

(5) Money, and the right to receive money not evidenced by a security other than an obligation described as nonexempt property in section 373 (e) (2) or (3). The term "the right to receive money" includes, among other items, accounts receivable, claims for damages, and rights to refunds of taxes.

(f) *"Stock or securities."* The term "stock or securities" is defined in section 373 (f) for the purposes of sections 371 to 373, inclusive. As therein defined the term includes voting trust certificates and stock rights or warrants.

TAX OF SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS

SEC. 391. APPLICABILITY OF SUPPLEMENT [as added by sec. 502, 2d Rev. Act 1940].

If a personal service corporation (as defined in section 725) is exempt under such section for any taxable year from the excess profits tax imposed by such subchapter, the provisions of this Supplement shall be applicable with respect to each shareholder of such corporation who was a shareholder in such corporation on the last day of such taxable year of the corporation.

§ 29.391–1 *Applicability of Supplement S.* If a personal service corporation (as defined in section 725 and the regulations thereunder) elects not to be subject to the excess profits tax for any taxable year, then Supplement S (sections 391 to 396, inclusive) shall be applicable with respect to each person who was a shareholder of such corporation at the close of the taxable year of the corporation. (See section 725 (b).)

SEC. 392. UNDISTRIBUTED SUPPLEMENT S NET INCOME [as added by sec. 502, 2d Rev. Act 1940].

For the purposes of this chapter, the term "undistributed Supplement S net income" means the Supplement S net income (as defined in section 393) minus the amount of the dividends paid during the taxable year. For the purposes of this section the amount of dividends paid shall be computed in the same manner as provided in subsections (d) (e), (f), (g), (h), and (i) of section 27 for the purpose of the basic surtax credit provided in section 27.

§ 29.392–1 *Undistributed Supplement S net income.* The term "undistributed Supplement S net income" means Supplement S net income (as defined in section 393) minus the amount of dividends paid by the corporation during the taxable year. For the method of computing dividends paid, see subsections (d), (e), (f), (g), (h), and (i) of section 27 and the regulations thereunder.

SEC. 393. SUPPLEMENT S NET INCOME [as added by sec. 502, 2d Rev. Act 1940, and as amended by sec. 135 (b), Rev. Act 1942].

For the purposes of this chapter "Supplement S net income" means the net income, except that there shall be allowed as additional deductions—

(a) The Federal income tax payable under this chapter for the taxable year; and

(b) In lieu of the deduction allowed by section 23 (q), contributions or gifts, payment of which is made within the taxable year, to or for the use of donees described in section 23 (q) for the purposes therein specified, to an amount which does not exceed 15 per centum of the corporation's net income, computed without the benefit of this subsection and section 23 (q). For the purposes of this section, the net income shall be computed without regard to section 47 (c).

§ 29.393–1 *Supplement S net income.* The term "Supplement S net income" means the net income as defined in section 21, but computed without the deduction allowed under section 23 (q), minus the sum of the following:

(a) The Federal income tax payable under chapter 1 for the taxable year; and

(b) The amount of contributions or gifts made to or for the use of donees described in section 23 (q) for the purposes therein specified, to an amount which does not exceed 15 percent of the net income of the corporation computed without the benefit of sections 23 (q) and 393 (b).

In the case of a taxable year of less than 12 months on account of a change in the accounting period of the corporation, the corporate net income, as defined in section 21, is computed on the basis of the period included in the taxable year, and is not placed on an annual basis under the provisions of section 47 (c).

The deductions allowed under section 393 for contributions or gifts made to or for the use of donees described in section 23 (q) are in lieu of deductions otherwise allowable under section 23 (q) and are allowable only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records.

The provisions of the last two paragraphs of § 29.23 (o)–1 relating to (1) the statement in returns of the name and address of each organization to which a contribution or gift was made and the amount and the approximate date of the actual payment of the contribution or gift, (2) the substantiation of the claims for deductions when required by the Commissioner, and (3) the basis for calculation of the amount of a contribution or gift which is other than money, are equally applicable to claims for deductions of amounts of contributions or gifts by corporations under section 393.

The method of computing Supplement S net income may be illustrated by the following example:

Example. The X Corporation, a personal service corporation, has for the calendar year 1942 a net income, as computed under chapter 1, of $190,000. The Federal income tax payable under chapter 1 for that year amounts to $45,600. Contributions or gifts payment of which is made during the taxable year to or for the use of donees described in section 23 (q) for the purposes therein specified amount to $35,000. The Supplement S net income of the corporation is $124,400, computed as follows:

Net income under chapter 1		$190,000
Add: Contributions deductible in computing net income under section 21		10,000
Net income computed without the benefit of any deduction for contributions		200,000
Less: Federal income tax	$45,600	
Contributions deductible under section 393 (b) (15 percent of $200,000)	30,000	
		75,600
Supplement S net income		124,400

SEC. 394. CORPORATION INCOME TAXED TO SHAREHOLDERS [as added by sec. 502, 2d Rev. Act 1940, and as amended by sec. 126 (h), Rev. Act 1942].

(a) *General rule.* The undistributed Supplement S net income of a personal service corporation shall be included in the gross income of the shareholders in the manner and to the extent set forth in this Supplement.

(b) *Amount included in gross income.* Each shareholder who, on the last day of the taxable year of the corporation, was a shareholder in such corporation shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend if on such last day there had been distributed by the corporation, and received by the shareholders, an amount equal to the undistributed Supplement S net income of the corporation for its taxable year.

(c) *Credit for obligations of the United States and its instrumentalities.* Each such shareholder shall be allowed a credit against net income for the purposes of the tax imposed by section 11, 13, 14, 201, 204, 207, or 362, of his proportionate share of the interest specified in section 25 (a) (1) or (2) which is included in the gross income of the corporation. For any taxable year of the corporation beginning after December 31, 1941, each such shareholder's proportionate share of such interest received by the corporation shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 23 (v) as is attributable to such share.

(d) *Effect on capital account of personal service corporation.* An amount equal to the undistributed Supplement S net income of the personal service corporation for its taxable year shall be considered as paid in as of the close of such taxable year as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of such taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend in the gross income of the shareholders.

(e) *Basis of stock in hands of shareholders.* The amount required to be included in the gross income of the shareholder under subsection (b) shall, for the purpose of adjusting the basis of his stock with respect to which the distribution would have been made (if it had been made), be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in the last determination of the shareholder's tax liability, made before the expiration of seven years after the date prescribed by law for filing the return.

(f) *Period of limitation on assesssment and collection.* For period of limitation on assessment and collection without assessment, in the case of failure to include a gross income the amount properly includible therein under subsection (b), see section 275 (d).

§ 29.394–1 *Taxability of shareholders.* If, by reason of an election under section 725, a personal service corporation is exempt for any taxable year from the excess profits tax imposed under subchapter E of chapter 2, the undistributed Supplement S net income of the corporation shall be treated as a dividend received by those who, at the close of the taxable year of the corporation, were the shareholders of the corporation and as such would have been entitled to receive such income as a dividend had it been distributed at that time. Each such shareholder for his taxable year in which or with which the taxable year of the corporation ends, shall include in his gross income his proportionate share of such undistributed Supplement S net income as though such proportionate share had been received as a dividend on the last day of the taxable year of the corporation. Such amount is to be determined by reference to the interest of the shareholder in the corporation, that is, by reference to the number of shares of stock owned and the relative rights of each class of stock if there are several classes of stock outstanding. Thus, if a personal service corporation has both common and preferred stock outstanding and the preferred shareholders are entitled to a specified dividend before any distribution may be made to the holders of the common stock, then the assumed distribution of the undistributed Supplement S net income must first be treated as a payment of the specified dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

§ 29.394–2 *Credit for interest on obligations of the United States and its instrumentalities.* Each shareholder of a personal service corporation who as of the last day of the taxable year of the corporation is required to include in his gross income his proportionate share of the undistributed Supplement S net income of the corporation shall, for the purposes of the tax imposed by section 11 (normal income tax), section 13 (tax on corporations in general), section 14 (tax on special classes of corporations), section 201 (tax on life insurance companies), section 204 (tax on insurance companies other than life or mutual), section 207 (tax on mutual insurance companies other than life), or section 362 (tax on mutual investment companies), be allowed a credit against net income of his proportionate share of the interest specified in section 25 (a) (1), interest on United States obligations or section 25 (a) (2), interest on obligations of instrumentalities of the United States, which is included in the gross income of the corporation. (For reduction of credit for such interest on account of amortizable bond premium, see § 29.125–9.)

§ 29.394–3 *Effect on capital account of personal service corporation.* If the undistributed Supplement S net income of a personal service corporation, or any portion thereof, for any taxable year is required to be included in the gross income of the shareholders, such undistributed Supplement S net income shall, for income tax and excess profits tax purposes, be treated as paid-in surplus or as a contribution to capital, paid in as of the close of such taxable year and the accumulated earnings and profits of the corporation shall be correspondingly reduced.

§ 29.394–4 *Basis of stock in hands of shareholders.* If a shareholder of a personal service corporation is required to include in his gross income his proportionate part of the undistributed Supplement S net income of the corporation, the amount so included shall, for the purpose of adjusting the basis of his stock with respect to such proportionate part, be treated as a distribution actually made by the corporation and as a reinvestment in the corporation by the shareholder. It shall, however, be so treated only to the extent to which such amount is included in the return of the shareholder, increased or decreased by any adjustment of such amount in the last determination of the tax liability of the shareholder made before the expiration of seven years after the date prescribed by law for the filing of his return.

SEC. 395. NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS [as added by sec. 502, 2d Rev. Act 1940].

In the case of a shareholder taxable under section 211 (a) or 231 (a), his distributive share of the undistributed Supplement S net income of the corporation required to be included in the gross income shall be considered as a dividend received by him from sources within the United States.

SEC. 396. SHAREHOLDER'S TAX PAID BY CORPORATION [as added by sec. 502, 2d Rev. Act 1940].

If a personal service corporation is exempt for any taxable year under section 725 from excess profits tax, it shall, at the time of filing its return, pay to the collector an amount equal to the amount that would be required by section 143 (b) or section 144 to be deducted and withheld by the corporation if any amount required by this Supplement to be included in the gross income of the shareholder had been, on the last day of the taxable year of the corporation paid to the shareholder in cash as a dividend. Such amount shall be collected and paid in the same manner as the amount of tax due in excess of that shown by the taxpayer upon a return in the case of a mathematical error appearing on the face of the return.

§ 29.396–1 *Tax of certain shareholders paid by the corporation.* Since a shareholder's proportionate share of the undistributed Supplement S net income of a corporation electing not to be subject to the excess profits tax is taxable to such shareholder, the corporation is required, at the time of filing its income tax return under chapter 1, to pay to the collector an amount equal to the amount that would be required by section 143 (b) or section 144 to be deducted and withheld by the corporation had its undistributed Supplement S net income been actually paid in cash to its shareholders as a dividend on the last day of its taxable year.

INDIVIDUALS WITH GROSS INCOME FROM CERTAIN SOURCES OF $3,000 OR LESS

SEC. 400. IMPOSITION OF TAX [as added by sec. 102 (a), Rev. Act 1941, and as amended by sec. 104 (a), Rev. Act 1942].

In lieu of the tax imposed under sections 11 and 12, an individual who makes his return on the cash basis may elect, for each taxable year, to pay the tax shown in the following table if his gross income from such taxable year is $3,000 or less and consists wholly of one or more of the following: Salary, wages, compensation for personal services, dividends, interest, or annuities:

If gross income is over—	But not over—	The tax shall be— Single person (not head of a family)	Married person making separate return	(1) Married person whose spouse has no gross income or (2) Married person making joint return or (3) Head of family
$0	$525	$0	$0	$0
$525	550	1	0	0
$550	575	4	0	0
$575	600	6	0	0
$600	625	11	0	0
$625	650	15	0	0
$650	675	20	3	0
$675	700	24	6	0
$700	725	28	9	0
$725	750	33	14	0
$750	775	37	18	0
$775	800	41	22	0
$800	825	46	27	0
$825	850	50	31	0
$850	875	54	35	0
$875	900	59	40	0
$900	925	63	44	0
$925	950	67	48	0
$950	975	71	52	0
$975	1,000	76	57	0
$1,000	1,025	80	61	0
$1,025	1,050	84	65	0
$1,050	1,075	89	70	0
$1,075	1,100	93	74	0
$1,100	1,125	97	78	0
$1,125	1,150	102	83	0
$1,150	1,175	106	87	0
$1,175	1,200	110	91	0
$1,200	1,225	115	96	0
$1,225	1,250	119	100	0
$1,250	1,275	123	104	0
$1,275	1,300	128	109	1
$1,300	1,325	132	113	4
$1,325	1,350	136	117	7
$1,350	1,375	141	122	10
$1,375	1,400	145	126	14
$1,400	1,425	149	130	17
$1,425	1,450	154	135	21
$1,450	1,475	158	139	25
$1,475	1,500	162	143	29
$1,500	1,525	167	148	34
$1,525	1,550	171	152	38
$1,550	1,575	175	156	42
$1,575	1,600	180	161	47
$1,600	1,625	184	165	51
$1,625	1,650	188	169	55
$1,650	1,675	193	174	60
$1,675	1,700	197	178	64
$1,700	1,725	201	182	68
$1,725	1,750	206	187	73
$1,750	1,775	210	191	77
$1,775	1,800	214	195	81
$1,800	1,825	218	199	85
$1,825	1,850	223	204	90
$1,850	1,875	227	208	94
$1,875	1,900	231	212	98
$1,900	1,925	236	217	103
$1,925	1,950	240	221	107
$1,950	1,975	244	225	111
$1,975	2,000	249	230	116
$2,000	2,025	253	234	120
$2,025	2,050	257	238	124
$2,050	2,075	262	243	129
$2,075	2,100	266	247	133
$2,100	2,125	270	251	137
$2,125	2,150	275	256	142
$2,150	2,175	279	260	146
$2,175	2,200	283	264	150
$2,200	2,225	288	269	155
$2,225	2,250	292	273	159
$2,250	2,275	296	277	163
$2,275	2,300	301	282	168
$2,300	2,325	305	286	172
$2,325	2,350	309	290	176
$2,350	2,375	314	295	181
$2,375	2,400	318	299	185
$2,400	2,425	322	303	189
$2,425	2,450	327	308	194
$2,450	2,475	331	312	198
$2,475	2,500	335	316	202
$2,500	2,525	340	321	207
$2,525	2,550	344	325	211
$2,550	2,575	348	329	215
$2,575	2,600	353	334	220
$2,600	2,625	357	338	224
$2,625	2,650	361	342	228
$2,650	2,675	366	347	233
$2,675	2,700	371	351	237
$2,700	2,725	376	355	241
$2,725	2,750	381	359	245
$2,750	2,775	386	364	250
$2,775	2,800	391	369	254
$2,800	2,825	396	374	258
$2,825	2,850	401	379	263
$2,850	2,875	406	384	267
$2,875	2,900	411	389	271
$2,900	2,925	416	394	276
$2,925	2,950	421	399	280
$2,950	2,975	426	404	284
$2,975	3,000	431	409	289

In applying the above schedule to determine the tax of a taxpayer with one or more dependents there shall be substracted from his gross income $385 for each such dependent.

§ 29.400–1 *Scope and application of Supplement T.* For the calendar year 1942 and subsequent calendar years, in lieu of the tax imposed under sections 11 and 12, an individual who makes his return on a cash basis may elect to pay the tax imposed under section 400, if his gross income does not exceed $3,000, and if his gross income consists wholly of one or more of the following: Salary, wages, compensation for personal services, dividends, interest, or annuities. For the purposes of the $3,000 limitation, the amount of an individual's gross income shall be determined without subtracting any amount on account of such individual's dependents. For example, A, a single person who is not the head of a family, has a gross income, consisting of salary, of $3,200 for 1942. He has two dependents. For the purpose of the $3,000 limitation, his gross income is $3,200, not $2,430 ($3,200 minus $770), and consequently he may not compute his tax under Supplement T (sections 400 to 404, inclusive). An individual deriving any other kind of income, such as income from the conduct of a business or from a trust of which he is a beneficiary, or gains from the sale or exchange of property, may not compute his tax under Supplement T. If an individual derives income from a partnership of which he is a member or from a trust of which he is a beneficiary, and the partnership or trust previously derived the income distributed to him from, for example, interest, he will be considered to have received income from a partnership or trust, rather than from interest, and consequently will not be entitled to compute his tax under Supplement T.

A husband and wife living together on July 1 of the taxable year may file separate returns on Form 1040A, if the gross income of each is from the prescribed sources and does not exceed $3,000, or they may file a single joint return on such form if their combined gross income is from the prescribed sources and does not exceed $3,000. A married person living with husband or wife at any time during the calendar year may not compute the tax under Supplement T if the other spouse makes an income tax return without regard to such Supplement (see § 29.404–1).

If an individual dies before the close of the calendar year, his tax may not be determined under Supplement T. Nor may the tax of the surviving spouse of an individual who has gross income and who dies before the close of the calendar year be determined under Supplement T. (See sections 404 and 47 (g).)

In order to determine the amount of his tax an individual merely ascertains the amount of his gross income, subtracts $385 for each dependent for whom a credit is allowable and refers to the amended schedule set forth in section 400 to find the amount of his tax. If the taxpayer is the head of a family only by reason of his having one or more dependents, he may subtract from his gross income $385 for all except one of such dependents (see example (4) in § 29.401–1). If the taxpayer is a single person who is not the head of a family, his tax is set forth in the third column of the amended schedule. If the taxpayer is a married person making a separate return (but not including a taxpayer whose spouse makes a return without regard to Supplement T), the tax is set forth in the fourth column of the amended schedule. If the taxpayer is (1) a married person whose spouse has no gross income, (2) a married

person making a joint return, or (3) the head of a family, the tax is set forth in the fifth column of the amended schedule. Under the amended schedule no tax is imposed upon a single person whose gross income (less credit for dependents) does not exceed $525, or upon a married person making a separate return whose gross income less credit for dependents) does not exceed $650, or upon (1) a married person whose spouse has no gross income, (2) a married person making a joint return, or (3) the head of a family, whose gross income (less credit for dependents) does not exceed $1,275.

SEC. 401. RULES FOR APPLICATION OF SECTION 400 [as added by sec. 102 (a), Rev. Act 1941, and as amended by sec. 104 (b), Rev. Act 1942].

For the purposes of this supplement—

(a) *Definitions.* (1) "Married person" means a married person living with husband or wife on July 1 of the taxable year.

(2) "Dependent" means a person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer on July 1 of the taxable year if on such date such dependent person is under eighteen years of age, or is incapable of self-support because mentally or physically defective, excluding as a dependent, in the case of a head of a family, one who would be excluded under section 25 (b) (2) (B). A payment to a wife which is includible under section 22 (k) or section 171 in the gross income of such wife shall not be considered a payment by her husband for the support of any dependent.

(b) *Married and not living with husband or wife.* An individual not a head of a family and not living with husband or wife on July 1 of the taxable year shall be treated as a single person.

§ 29.401–1 *Rules for application of schedule in section 400.* For the calendar year 1942 and subsequent calendar years, the determination of whether a taxpayer is a single person, a married person, or the head of a family, or whether he has a dependent, is to be made as of July 1 of such taxpayer's taxable year.

Example (1). For the calendar year 1942, A, an unmarried person has a gross income of $2,832 derived wholly from salary and interest. During the first five months of 1942, A's status is that of head of a family, but on July 1, 1942, his status is that of a single person not the head of a family. To determine the tax imposed upon him for the calendar year 1942 under section 400, A refers to column 3 of the schedule (applicable to a single person who is not the head of a family) and finds that the tax imposed upon a taxpayer whose gross income falls within the bracket running from $2,825 to $2,850 is $401. Since $2,832 is within this bracket, A's tax is $401.

Example (2). For the calendar year 1942, B has a gross income of $2,312, derived wholly from salary and dividends, and C, his wife, has gross income of $671, derived wholly from wages and an annuity. On July 1, 1942, they are living together and B is supporting two dependent children, both of whom are under the age of 18. B and C file separate returns under Supplement T. To determine his tax for the calendar year 1942, B subtracts $770 from $2,312, refers to column 4 of the schedule (applicable to married person making separate return), and finds that the tax imposed upon a taxpayer whose gross income falls within the bracket running from $1,525 to $1,550 is $152. Since $1,542 ($2,312 minus $770) is within this bracket, B's tax is $152. To determine her tax for such year, C refers to column 4 of the schedule (applicable to married person making separate return) and finds that the tax imposed upon a taxpayer whose gross income falls within the bracket running from $650 to $675 is $3. Since $671 is within this bracket, C's tax is $3. Under such facts, if B and C file a joint return under Supplement T, their combined gross income is $2,983. To determine their tax, they subtract $770 and refer to column 5 of the schedule (applicable to married person making joint return) and find that the tax imposed upon a taxpayer whose gross income falls within the bracket running from $2,200 to $2,225 is $155. Since $2,213 ($2,983 minus $770) is within this bracket, the combined tax of B and C is $155.

Example (3). For the calendar year 1942, D has a gross income of $1,860, derived wholly from wages. He was married on April 1, 1942, and he and his wife were living together on July 1, 1942. He has no dependents. His wife, who has no gross income in 1942, dies on December 1, 1942. To determine his tax for the calendar year 1942, D refers to column 5 of the schedule (applicable to a married person whose spouse has no gross income), and finds that the tax imposed upon a taxpayer whose gross income falls within the bracket running from $1,850 to $1,875 is $94. Since $1,860 is within this bracket, D's tax is $94.

Example (4). For the calendar year 1942, E has a gross income of $2,965. His wife, who has no gross income in 1942, dies on May 15, 1942, and on July 1, 1942, he is supporting and maintaining a home for two dependent children both of whom are under the age of 18. Since E would not occupy the status of head of a family except for the fact that he maintains a home for such children, no amount may be subtracted from gross income on account of one of such children. To determine his tax for the calendar year 1942, E subtracts only $385 and refers to column 5 of the schedule (applicable to head of family) and finds that the tax in the case of a taxpayer whose gross income falls in the bracket running from $2,575 to $2,600 is $220. Since $2,580 ($2,965 minus $385) is within this bracket, E's tax is $220. If the wife had had gross income, the tax of neither spouse could be determined under Supplement T.

Payments to a wife in the nature of, or in lieu of, alimony which are includible in her gross income under sections (22) (k) and 171 may not be considered as a payment by her husband for the support of any dependent (for definition of husband and wife for purposes of this sentence, see section 3797 (a) (17)).

SEC. 402. MANNER OF ELECTION [as added by sec. 102 (a), Rev. Act 1941].

The election referred to in section 400 shall be considered to have been made if the taxpayer files the return prescribed for this Supplement and such election shall be irrevocable. If the taxpayer for any taxable year has filed a return computing his tax without regard to this Supplement, he may not thereafter elect for such year to compute his tax under this Supplement.

§ 29.402–1 *Manner of election to compute tax under Supplement T.* A taxpayer elects to compute his income tax under Supplement T (sections 400 to 404, inclusive) by filing a return of his gross income on Form 1040A, the form prescribed for this Supplement. If a husband and wife both make such an election, they may file a joint return reporting their aggregate gross income or they may file separate returns reporting their respective gross incomes. If they file separate returns, the tax of each shall be computed by reference to the fourth column of the schedule set forth in section 400.

An election under Supplement T once made for the taxable year may not be revoked by an amended return or otherwise, but a new election is allowed for each subsequent taxable year. If for any taxable year the taxpayer makes a return without regard to Supplement T, he may not thereafter elect to have his tax computed under such supplement for that taxable year.

SEC. 403. CREDITS AGAINST TAX NOT ALLOWED [as added by sec. 102 (a), Rev. Act 1941].

Section 31 (relating to foreign tax credit) and section 32 (relating to credit for taxes withheld at source) shall not apply with espect to the tax imposed by this Supplement.

SEC. 404. CERTAIN TAXPAYERS INELIGIBLE [as added by sec. 102 (a), Rev. Act 1941, and as amended by sec. 104 (c), Rev. Act 1942].

This supplement shall not apply to a nonresident alien individual, to an estate or trust, to an individual filing a return for a period of less than twelve months or for any taxable year other than a calendar year, or to a married individual married and living with husband or wife at any time during the taxable year whose spouse files return and computes tax without regard to this supplement.

§ 29.404–1 *Taxpayer to whom Supplement T is inapplicable.* The following taxpayers are not entitled to file a return and pay tax under Supplement T:

(a) A nonresident alien individual;

(b) An estate or trust;

(c) An individual who files a return for a period of less than 12 months or for any taxable year other than a calendar year; or

d) An individual who is married and living with husband or wife at any time during the calendar year and whose spouse files an income tax return for such year without regard to Supplement T.

ABATEMENT OF TAX FOR MEMBERS OF ARMED FORCES UPON DEATH

SEC. 421. ABATEMENT OF TAX FOR MEMBERS OF ARMED FORCES UPON DEATH [as added by sec. 8, Current Tax Payment Act 1943].

In the case of any individual who dies on or after December 7, 1941, while in active service as a member of the military or naval forces of the United States or of any of the other United Nations and prior to the termination of the present war as proclaimed by the President, the tax imposed by this chapter shall not apply with respect to the taxable year in which falls the date of his death, and the tax under this chapter and under the corresponding title of each prior revenue law for preceding taxable years which is unpaid at the date of his death (including interest, additions to the tax, and additional amounts) shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

[Subparts D, E, F, and G will appear in the issue for Friday, November 5, 1943.]

[SEAL] ROBERT E. HANNEGAN,
Commissioner of Internal Revenue.

Approved: October 26, 1943.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

[F. R. Doc. 43–17458; Filed, October 28, 1943; 9:43 a. m.]

TITLE 30—MINERAL RESOURCES

Chapter VI—Solid Fuels Administration for War

[Regulation 7]

PART 602—GENERAL ORDERS AND DIRECTIVES

RESTRICTIONS ON DELIVERIES OF BITUMINOUS COAL BY RETAIL DEALERS

The present interruptions in the production of bituminous coal and the fulfillment of requirements for the defense of the United States will create a critical shortage in the supply of bituminous coal for defense, for private account, and for export. In order to insure the equitable distribution of the available supply of bituminous coal, it is necessary as a precautionary measure to place restrictions upon deliveries of bituminous coal by retail dealers. Accordingly, in order to effectuate the purposes of Executive Order No. 9332 and by virtue of the authority conferred by that order, the following regulation is issued by the Solid Fuels Administrator for War:

§ 602.141 *Definitions.* (a) "Bituminous coal" means all bituminous and subbituminous coal having calorific value in British thermal units of more than seven thousand six hundred per pound and having a natural moisture content in place in the mine of less than 30 per centum, and all coal designated as lignite produced in the State of Wyoming having calorific value in British thermal units of more than seven thousand six hundred per pound and having a natural moisture content in place in the mine of less than 30 per centum or more.

(b) "Retail dealer" means any person who acts in the capacity of a seller of bituminous coal in a transaction involving the sale, or sale and delivery, of broken bulk bituminous coal, physically handled in less than carload lots, without regard to quantity or frequency of delivery.

(c) "Ten days' supply" includes all bituminous coal of any usable kind, grade or size in the consumer's bin or other storage facility required by reasonable estimate to meet minimum bituminous requirements of the consumer for a ten-day period.

(d) "Industrial consumer" means any person who uses sizes or grades of bituminous coal not generally used by non-industrial consumers.

(e) "Non-industrial consumer" means any person who uses coal in a household, hospital, or similar institution, doctor's office, hotel, apartment building, drug store, food store or market, restaurant, or federal, state or municipal building.

§ 602.142 *Restrictions upon bituminous coal deliveries by retail dealers.* (a) No retail dealer shall deliver any bituminous coal to any consumer if such consumer has more than a ten days' supply; and no consumer shall accept delivery of any bituminous coal from a retail dealer if such consumer has more than a ten days' supply.

(b) A retail dealer may deliver bituminous coal in any quantity to any industrial consumer: *Provided,* That the tonnage delivered, when added to the inventory on hand, does not exceed a ten days' supply: *And provided further,* That the delivery is required to prevent irreparable damage at the industrial consumer's plant or building.

(c) A retail dealer may deliver bituminous coal up to but not in excess of one ton to any household consumer if such consumer has less than a ten days' supply. A retail dealer may deliver bituminous coal in any quantity to non-industrial consumers other than household consumers: *Provided,* That the tonnage delivered, when added to the inventory on hand, does not exceed a ten days' supply.

(d) The restriction of this section shall apply regardless of whether any consumer had title to any coal in the possession of any retail dealer on the effective date of this regulation.

§ 602.143 *Contemplated activities of local committees of the Office of Defense Transportation.* (a) It is understood that local committees functioning under the direction of the Office of Defense Transportation will, during the period of work stoppages in the bituminous producing districts and during the effective period of this regulation, ascertain the amount of bituminous in retail yard storage piles in their communities, will arrange for the pooling of retail dealer deliveries and will coordinate in other ways retail dealer activities in each bituminous consuming community.

(b) It is understood that the local committees functioning under the direction of the Office of Defense Transportation will indicate to the regional offices of the Solid Fuels Administration for War the tonnages of bituminous coal critically needed by those communities having insufficient bituminous to forestall suffering threatened by weather conditions. The Solid Fuels Administrator for War will, upon the recommendation of such local committees, arrange, so far as practicable and appropriate, for the shipment of sufficient tonnages of bituminous that is now being held, pursuant to direction of the Solid Fuels Administration for War, in the bituminous producing districts for distribution into those communities whose need for bituminous appears to be critical.

§ 602.144 *Violations.* Any person who wilfully violates any provision of this regulation is guilty of a crime, and upon conviction may be punished by fine or imprisonment. In addition, any such person may be prohibited from making or obtaining further deliveries of, or from processing or using material under priority control and may be deprived of priorities assistance.

§ 602.145 *Communications.* All communications regarding this regulation should be addressed to the Solid Fuels Administrator for War, Washington, D. C.

This regulation shall become effective immediately.

(E.O. 9332, 8 F.R. 5355; E.O. 9125, 7 F.R. 2719; sec. 2 (a), 54 Stat. 676, as amended by 55 Stat. 236 and 56 Stat. 176)

Issued this 2d day of November 1943.

HAROLD L. ICKES,
Solid Fuels Administrator for War.

[F. R. Doc. 43-17738; Filed, November 3, 1943; 10:42 a. m.]

[Order 8]

BITUMINOUS COAL

AMENDMENT OF WAR PRODUCTION BOARD ORDER

Pursuant to the provisions contained in § 3247.1 (e) of War Production Board Order No. M-316,[1] in order to assure the most efficient distribution of the supply of coal in the interest of the war and essential civilian production, I hereby direct and order:

1. That § 3247.1 (d) of War Production Board Order No. M-316, as amended by my orders dated June 1 and June 21, 1943, is amended to read as follows:

(d) *Exceptions.* The provisions of this order shall not apply to:

(1) Coal specifically consigned for all-rail shipments to Canadian destinations.

(2) Coal specifically consigned for water movement after dumping from cars (other than coal moving to lower Lake dumping ports). The coal which has been loaded into cars after completion of such water movement shall be subject to the order.

(3) Coal specifically consigned for use aboard any vessel.

(4) Delivery to a consignee's siding without the undertaking required by paragraph (a) (2), if the railroad informs the consignee that delivery is made for the railroad's convenience and that the coal is still subject to reconsignment under this order. The consignee shall not unload any such coal without giving the undertaking provided in paragraph (a) (2) to the railroad which made delivery.

(5) Delivery to a connecting carrier.

(6) Any transaction which may be specifically permitted by the Interstate Commerce Commission or the Solid Fuels Administrator for War.

(7) Coal loaded in cars at the mine tipple on and after November 1, 1943, of a mine which has not suspended operations or which has resumed operations since November 1, 1943: *Provided,* That the billing covering such cars shall be endorsed "mine in operation, authority I. C. C. Service Order No. 120-F."

(8) Coal specifically consigned for all-rail movement to a retail dealer.

(9) Unbilled coal now held at the mines: *Provided,* That the billing covering such coal shall be endorsed "no-bill coal, authority I. C. C. Service Order No. 120-F."

2. That § 3247.1 (g) (4) of War Production Board Order No. M-316 is amended by deleting the last sentence thereof so that the section reads as follows:

(4) "Ten days' supply" includes all bituminous coal of any usable kind, grade or size on hand or available. Any person who has coal in transit (if not restricted by this order) or has coal located away from the place of consumption must take such coal into account in computing whether he has a ten days' supply to the extent that such coal will be available or can practicably be made available at the place of consumption within ten days. A ten days' supply shall be deemed to include any additional amount necessary

[1] 8 F.R. 5677, 5801, 7412, 7630, 8698, 8743.

to avoid delivery of a fraction of a carload.

(3) That Appendix A to War Production Board Order No. M–316 is amended to read as follows:

In order to establish the right of the undersigned to receive delivery of bituminous coal under the restrictions of War Production Board Order No. M–316, the undersigned certifies to (*Name of Railroad*) and to the War Production Board that the undersigned has not, and will not have after receiving the coal identified below, more than a ten days' supply thereof as defined in said order and that unless it obtains such coal it will suffer extensive and irreparable damage from a shut down of its plant. The undersigned (if not the original consignee of the coal) agrees, in consideration of receipt of such coal, to pay all obligations of the consignee to the consignor with respect to such coal and to pay to said railroad all applicable transportation charges, demurrage charges, and other accessorial charges.

(Date)

(Name of person receiving coal)

By ----------
(Signature of authorized official)

Identification of bituminous coal covered by this undertaking:

4. That my order of June 23, 1943, to the extent it suspends the provisions of the aforementioned War Production Board Order, is terminated and War Production Board Order No. M–316, as amended by my orders dated June 1 and June 21, 1943, and as further hereinabove amended, shall be deemed to be reinstated and effective, with the same force and effect as if its provisions had not been suspended.

5. That, except as provided in § 3247.1 (d) (7) and (9), as hereinabove amended, my directives of October 29, 1943, directing producers to hold on their mine tracks unbilled, pending further instructions from the Solid Fuels Administration, the maximum possible number of cars, preferably of lump and double screened coal, consistent with continuous full mine operation and to report the number of cars by sizes held at each mine pursuant to such directives to their area distribution managers shall remain in full force and effect notwithstanding any provision of this order.

This order shall become effective at six o'clock p. m., e. w. t., November 1, 1943.

Issued this 1st day of November 1943.

HAROLD L. ICKES,
Solid Fuels Administrator for War.

[F. R. Doc. 43–17739; Filed, November 3, 1943; 10:42 a. m.]

TITLE 32—NATIONAL DEFENSE

Chapter IX—War Production Board

Subchapter B—Executive Vice-Chairman

AUTHORITY: Regulations in this subchapter issued under sec. 2 (a), 54 Stat. 676, as amended by 55 Stat. 236 and 56 Stat. 176; E.O. 9024, 7 F.R. 329; E.O. 9125, 7 F.R. 2719; W.P.B. Reg. 1 as amended March 24, 1943, 8 F.R. 3666, 3696; Pri. Reg. 1 as amended May 15, 1943, 8 F.R. 6727.

PART 944—REGULATIONS APPLICABLE TO THE OPERATION OF THE PRIORITIES SYSTEM

[Interpretation 7 to Priorities Reg. 1]

MINIMUM SALE QUANTITIES AND PRODUCTION RUNS

The following interpretation is issued with respect to Priorities Regulation 1:

(a) *Applicable provisions of the regulations.* Section 944.14 of Priorities Regulation No. 1 forbids the making or acceptance of a delivery which will give the customer more than the "practicable minimum working inventory reasonably necessary" for him to make his own deliveries. A similar provision in paragraph (b) (2) of Priorities Regulation No. 3 says that a customer who is applying a rating for which no specific quantities have been authorized may use it only to get the "minimum required amounts".

(b) *Factors to be considered in determining how much can be ordered and delivered.* In determining a customer's minimum inventory "reasonably necessary" under Priorities Regulation No. 1 or his "minimum required amounts" under Priorities Regulation No. 3, it is proper in some cases to consider not only the immediate needs of the customer's plant but also whether the amount which he orders will be a minimum production run for his supplier. The customer may order and receive (and the supplier may deliver) the customer's requirements for a longer period in advance than he actually needs at the time of delivery if, but only if, it is not practicable for him to get the item from any supplier in the smaller quantities which he presently needs. The supplier may reject his customer's order if it is less than the minimum which he regularly sells, as explained in Interpretation 3 of Priorities Regulation No. 1. This means that if he regularly sells not less than a certain minimum production run, he does not have to accept orders which either total less than the run or which call for individual deliveries of less than the run.

(c) *Relief in exceptional cases.* If the conditions stated in paragraph (b) above cannot be satisfied but the customer wants to order or accept delivery of more than his actual needs at the time of delivery, he should apply to the Redistribution Division of the War Production Board for permission, stating the facts and why it is not practicable to satisfy the conditions of paragraph (b).

(d) *Special provisions for controlled materials and Class A products.* This interpretation does not apply to deliveries of controlled materials or Class A products under the Controlled Materials Plan. Rules regarding deliveries of controlled materials are given in CMP Regulation No. 2, and those for Class A products are explained in Interpretation 9 to CMP Regulation No. 1.

(e) *Specific limits on ratings may not be exceeded.* This interpretation does not apply to the use of a rating where a specific quantity is stated in the instrument assigning the rating. If a person is assigned a rating for a specific amount of material, he may not use it to get more. If he finds that he can only get the material in larger quantities, he should apply for a modification of the rating.

Issued this 3d day of November 1943.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

[F. R. Doc. 43–17760; Filed, November 3, 1943; 12:08 p. m.]

PART 1001—TIN

[General Preference Order M–43, as Amended Nov. 3, 1943]

The fulfillment of requirements for the defense of the United States has created a shortage in the supply of tin for defense, for private account and for export; and the following order is deemed necessary and appropriate in the public interest and to promote the national defense:

§ 1001.1 *General Preference Order M–43*—(a) *Applicability of regulations.* This order and all transactions affected thereby are subject to all applicable regulations of the War Production Board, as amended from time to time.

(b) *Applicability of order.* The prohibitions and restrictions contained in this order shall apply to the use of material in all items or articles hereafter manufactured irrespective of whether such items or articles are manufactured pursuant to a contract made prior or subsequent to January 9, 1943, or pursuant to a contract supported by an allotment symbol or a preference rating. Insofar as any other order of the War Production Board may have the effect of limiting or curtailing to a greater extent than herein provided the use of tin in the production of any item or article, the limitations of such other order shall be observed.

(c) *Definitions.* For the purposes of this order:

(1) "Tin" means and includes both pig tin and secondary tin.

(2) "Pig tin" means metal containing 98% or more by weight of the element tin, in shapes current in the trade (including anodes, small bars, and ingots) produced from ores, residues or scrap.

(3) "Secondary tin" means any material (except tin plate and terne plate as those terms are defined in Supplementary Order M–21–e) which contains less than 98% but not less than 1.5% by weight of the element tin.

(4) "Manufacture" means to fabricate, assemble, melt, cast, extrude, roll, turn, spin, produce, coat, or process in any way, but does not include the processing of tin ore, concentrates, residues or scrap into metallic tin.

(5) "Inventory" of a person includes the inventory of affiliates and subsidiaries of such person, and the inventory of others where such inventory is under the control of or under common control with, or available for the use of such person.

(6) "Implements of war" means combat end-products, complete for tactical operations (including, but not limited to, aircraft, ammunition, armaments, weapons, ships, tanks, military vehicles and radio and radar equipment), and any parts, assemblies or materials to be incorporated in any of the foregoing items. This term does not include facilities or equipment used to manufacture the foregoing items.

(7) "Base period" means the corresponding calendar quarter of 1940.

(8) "Distributor" means any person regularly engaged in the business of buying and selling tin, and includes warehousemen and jobbers.

(d) *General restrictions on use of tin.* (1) No product or article or part thereof shall be manufactured of pig tin if it is possible to use secondary tin for such purpose.

(2) No tin in any form shall be used in the manufacture of any item or in any

process appearing on List A of this order; nor shall tin be used for any purpose except to manufacture the items or for the purposes listed in Schedule 1 of this order, and then, only within the limitations and restrictions specified in Schedule 1 with respect to such item or purpose.

(e) *Restrictions on the use of certain tin products.* Except with the specific permission in writing of the War Production Board granted pursuant to appeal under paragraph (k), no person shall use any of the tin-bearing products on List B of this order in the manufacture or treating of any other product or article; provided, That when any such tin-bearing product is listed in Schedule 1, it may be used for the purposes for which it is permitted to be manufactured as specified in Schedule 1.

(f) *Restrictions on deliveries.* (1) No person shall deliver or accept delivery of pig tin without the specific authorization in writing of the War Production Board; provided, however, that in the absence of a contrary direction by the War Production Board, pig tin may be delivered without specific authorization:

(i) To the Metals Reserve Company or to any other corporation organized under section 5(d) of the Reconstruction Finance Corporation Act as amended (15 U. S. C., sec. 606 (b)), or to any duly authorized agent of any such corporation.

(ii) By any distributor in lots of three long tons or less up to but not exceeding a total of five long tons to any one customer in the same calendar month; provided, That the aggregate of such deliveries which any person may receive from all distributors pursuant to the authority of this paragraph shall in no event exceed five long tons in any calendar month; and provided further, that any person seeking such a delivery shall, at the time of placing his purchase order, file with the distributor a statement substantially in the following form, signed manually or as provided in Priorities Regulation No. 7 by an official duly authorized for such purpose:

The undersigned hereby certifies:

(a) That no allocation of pig tin has been made to the undersigned by the War Production Board during the calendar month in which delivery of the pig tin covered by the accompanying purchase order is specified;

(b) That such pig tin if delivered will not cause the undersigned's total receipts of pig tin from all distributors during the same calendar month pursuant to the authorization of paragraph (f) of General Preference Order M-43, as amended, to exceed five long tons; and

(c) That such pig tin will not be used or disposed of by the undersigned in violation of any order or regulation of the War Production Board.

(Name of purchaser)

By ---
(Duly authorized official)

(2) On or before the 10th day of each calendar month, each distributor shall report to the War Production Board in such form and detail as said Board may from time to time prescribe, (subject to the approval of the Bureau of the Budget pursuant to the Federal Reports Act of 1942) his transactions in all pig tin during the previous month.

(g) *Allocations.* The War Production Board will from time to time allocate the supply of pig tin, including all pig tin released by the Metals Reserve Company, and issue specific directions as to the source, destination, and the amount of pig tin to be delivered or acquired. The War Production Board may also specifically direct the purposes and end products for which any person may convert, process or fabricate pig tin allocated to him.

(h) *Applications for, and reports of pig tin.* Application for allocations of pig tin or for specific authorization to accept delivery thereof under paragraph (f) shall be made to the War Production Board not later than the 20th day of the month next preceding the month in which delivery is desired, on Form PD-213 or such other form as the War Production Board may from time to time prescribe. Any person who on the first day of a calendar month has in his possession or under his control two long tons or more of pig tin or who used during the preceding calendar month, 3,000 pounds or more of pig tin, shall, not later than the 20th day of such month, report to the War Production Board on Form PD-213 in accordance with the instructions accompanying such form, regardless of whether or not he seeks an allocation of pig tin or specific authorization to accept delivery thereof during the next succeeding month.

(i) *Prohibitions against sales or deliveries with knowledge of intended misuse.* Notwithstanding the authorization by the War Production Board of a sale or delivery of tin, no person shall sell or deliver any tin or tin-bearing material or product thereof in the form of raw materials, semi-processed materials, finished parts or sub-assemblies to any person if he knows or has reason to believe such material or any product thereof is to be used in violation of the terms of this order. A supplier may rely upon the written statement of the customer seeking delivery of any such material, as to the purposes for which it will be used, unless the supplier knows or has reason to believe such statement to be false, and any such statement shall constitute on the part of the person making the same, a representation to the War Production Board within the meaning of section 35 (A) of the United States Criminal Code, 18 U. S. C. Sec. 80.

(j) *Limitation on inventories.* No person shall receive delivery of tin, or products thereof, in the form of raw materials, semi-processed materials, finished parts or sub-assemblies nor shall he put into process any raw material, in quantities which in either case shall result in an inventory of such raw, semi-processed or finished material in excess of a minimum practicable working inventory, taking into consideration the limitations placed upon the production of tin products by this order. In the absence of special permission to acquire or hold a greater supply of pig tin, forty-five days' inventory of such tin shall, for the purposes of this order, be deemed a practicable working inventory for any person except a manufacturer of tin plate as tin plate is defined in Supplementary Order M-21-e, as from time to time amended. Application for such special permission shall be made by letter to the War Production Board setting forth fully the facts upon which the applicant relies.

(k) *Appeals and communications.* Any appeal from the provisions of this order shall be made by filing a letter, referring to the particular provision appealed from and stating fully the grounds of the appeal. Appeals, reports and all communications concerning this order shall, unless otherwise directed, be addressed to the War Production Board, Tin and Lead Division, Washington 25, D. C., reference: M-43.

(l) *Violations.* Any person who wilfully violates any provision of this order, or who, in connection with this order, wilfully conceals a material fact or furnishes false information to any department or agency of the United States is guilty of a crime, and upon conviction may be punished by fine or imprisonment. In addition, any such person may be prohibited from making or obtaining further deliveries of, or from processing or using, material under priority control and may be deprived of priorities assistance.

Issued this 3d day of November 1943.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

LIST A

Pursuant to the foregoing order, the use of tin in any form, including semi-finished and finished products, in the manufacture of the items and for the purposes listed below is prohibited:

1. Advertising specialties.
2. Art objects.
3. Automobile body solder, or any similar material commonly used as a filler or smoother for automobile or truck bodies or fenders except as permitted in Schedule 1, section (6) (x).
4. Band and other musical instruments (except as permitted in Schedule 1 under the item "pipe organs").
5. Britannia metal.
6. Broom wire.
7. Buckles.
8. Buttons.
9. Chimes and bells.
10. Emblems and insignia.
11. Fasteners: eyelets, spiral binders, office and industrial staples, book match clips, paper clips, slide fasteners, dress hooks.
12. Foil (except as permitted in Schedule 1 under the item "foil").
13. Zinc galvanizing.
14. Household furnishings and equipment.
15. Jewelry.
16. Kitchen equipment (including cutlery and tableware), except as permitted in Schedule 1, sections (10) and (19).
17. Novelties, souvenirs and trophies.
18. Ornaments and ornamental fittings.
19. Pewter and pewter holloware.
20. Plating or coating for decorative purposes.
21. Powder (decorative).
22. Refrigerator trays and shelves.
23. Seals and labels.
24. Slot, game and vending machines.
25. Coated paper.

Sec.
26. Tin oxide.
27. Toys and games.

LIST B

The following tin-bearing products shall not be used in the manufacture or treating of any other products except in accordance with the provisions of paragraph (e) of the foregoing order:

1. Automobile body solder or any similar material containing tin, commonly used as a filler or smoother for automobile or truck bodies or fenders.
2. Tin oxide.
3. Solder containing more than 21% by weight of tin.
4. Babbitt metal or similar alloys used as babbitt containing more than 12% by weight of tin.
5. Brittania metal, pewter metal or other similar tin-bearing alloy.
6. Foil containing more than 1% tin by weight.

SCHEDULE 1

Pursuant to the foregoing order, tin may be used only in the production of the items and for the purposes set forth in this Schedule, subject to any limitations, restrictions or conditions specified with respect to any such item or purpose, and then, only to the extent that substitution of a less critical material is impracticable:

(1) *Implements of war.* The conditions, restrictions and limitations set forth in this Schedule with respect to any listed item or purpose shall not apply to the manufacture of "implements of war" produced for the Army or Navy of the United States, the United States Maritime Commission, or the War Shipping Administration, where the use of tin in the grade and to the extent employed is required by the latest applicable specifications (including performance specifications, unless otherwise directed by the War Production Board) of the government service or agency for which the same are being produced.

(2) *Detonators and blasting caps (including electric blasting caps).* This item includes all necessary parts and accessories but is limited to detonators and blasting caps which are to be used in mining, quarrying or oil drilling operations. Necessary materials to be incorporated in such detonators or blasting caps shall be exempt from the limitations, conditions and restrictions specified in this Schedule with respect to any such material.

(3) *Tin plate, terne plate and terne metal.* Tin plate, terne plate and terne metal, as respectively defined in Supplementary Order M-21-e, as from time to time amended, may be manufactured as permitted under the provisions of said Supplementary Order. Terne metal, however, may be manufactured from secondary tin only.

(4) *Collapsible tubes.* The use of tin in the manufacture of collapsible tubes is permitted subject to the limitations and restrictions of Conservation Order M-115, as amended from time to time.

(5) *Brass and bronze.* The tin content of brass and bronze alloys shall be limited as follows according to the purposes for which such alloys are to be used:

(a) *Cast alloys.* (1) For the manufacture of high ratio worm gears, fire engine pump gears, jack nuts, feed nuts, elevating nuts, thrust washers or discs, machine tool spindle bearings, hydraulic pump bodies and ends for gear pumps, grinder spindle sleeve bearings, or step bearings—not more than 12% tin by weight.

(2) For the manufacture of heavy, slow cooling castings (such as, for example, steel mill screw down nuts) where for performance characteristics, the alpha-delta eutectoid must be retained—not more than 18% tin by weight.

NOTE: Former paragraph (a) (3) deleted, and former paragraphs (a) (4), (5), (6) redesignated (a) (3), (4), (5), Nov. 3, 1943.

(3) For the manufacture of piston rings for airbrake equipment—not more than 21.5% tin by weight.

(4) For the manufacture of piston rings for locomotives—not more than 20% tin by weight.

(5) For all other purposes, a maximum tin content of 9% by weight, unless the lead content of the alloy is equal to or greater than, the tin content, and in such event, not to exceed 12% by weight.

(b) *Wrought alloys.* (1) For the manufacture of thermostatic discs or diaphragms, bronze welding rods, fourdrinier warp wire or rifle nuts in air hammers—not more than 9% tin by weight.

(2) For all other purposes—not more than 5.8% tin by weight.

(6) *Solder.* In the manufacture of solder, the tin content shall be limited as follows, according to the purposes for which the solder is to be used:

(i) For the manufacture of open top sanitary cans—not more than 21% tin by weight until January 1, 1944 and then not more than 5% tin by weight.

(ii) For the maintenance and repair of electric motors and generators—not more than 40% tin by weight.

(iii) For the manufacture of agricultural equipment made from galvanized sheet (excluding dairy equipment and dairyware)—not more than 40% tin by weight.

(iv) For the fabrication or repair of galvanized sheet metal air, heat and refrigeration ducts, gutters, downspouts, leaders, and roofing—not more than 30% tin by weight.

(v) For the manufacture and repair of the following dairy and egg processing machinery and equipment as defined in Order L-292: Cheese vats, clarifiers, and separators (milk and egg processing plant sizes only), coolers, heaters and preheaters, dehydrators, filiers, filters, forewarmers, hot wells, homogenizers and high pressure sanitary pumps, pasteurizers, sanitary centrifugal and positive pumps, vacuum pans, and sanitary pipe lines in connection with soldering on sanitary ferrules and fittings—not more than 40% tin by weight.

(vi) For the repair of fluid milk shipping containers and other dairy equipment—not more than 30% tin by weight.

(vii) For the manufacture of electrical fuses—not more than 40% tin by weight.

(viii) For the repair and maintenance of automotive radiators—not more than 30% tin by weight, but only in the form of solid wire or cored wire solder.

(ix) For the repair and maintenance of lap and top combs used in the textile industry—not more than 30% tin by weight.

(x) For the *repair* of automotive bodies and fenders—not more than 3% tin by weight derived from secondary sources only.

(xi) For the repair of gas meters in accordance with Supplementary Order M-43-b, as amended—not more than 38% tin by weight.

(xii) For wiping lead sheathed cable joints or lead pipe joints—not more than 32.5% tin by weight.

(xiii) For use in the manufacture and repair of industrial instruments (as defined in Conservation Order L-134) and their associated control valves—50% tin by weight: *Provided,* That solder of a lower tin content shall be used whenever its use will not cause damage or change the physical or electrical properties of the part soldered.

(xiv) For the installation and repair of water service pipes connecting the piping of a structure with the outside water main—not more than 38% tin by weight.

(xv) For all other purposes, not more than 21% tin by weight.

The total quantity of tin which any person may use in the manufacture of solder during any calendar quarter, beginning January 1, 1943, shall be limited to 50% of the quantity used by him in the manufacture of solder during the base period.

(7) *Babbitt.* In the manufacture of babbitt metal and similar alloys used as babbitt, the tin content shall be limited as follows, according to the purposes for which it is to be used:

(i) For repair, maintenance or replacement in existing diesel engines, turbines, locomotive connecting rod or coupling rod bearings: *Provided in any such case,* That the design of the machine or equipment makes the substitution of lead base babbitt impossible—not more than 90% tin by weight.

(ii) For manufacture, repair, maintenance or replacement of multivane crosshead linings in locomotives—no restriction.

(iii) For repair, maintenance or replacement in an industrial engine, compressor, or pump being used by operator engaged in the petroleum industry; *Provided in any such case,* That any priorities assistance required for such repair, maintenance or replacement is obtained in accordance with Preference Rating Order P-98-b, as amended, and that the design of the machine or equipment makes the substitution of lead base babbitt impossible—not more than 90% tin by weight.

(iv) For repair, maintenance or replacement in vessels or shipping facilities pursuant to a preference rating duly established or assigned by the United States Maritime Commission—not more than 90% tin by weight.

(v) For manufacture, repair, maintenance or replacement in connecting rod and main engine bearings for motor vehicles of 16,000 pounds or more gross vehicle rating and for passenger carriers having a seating capacity of not less than 11 persons as defined in Limitation Order L-158—not more than 90% tin by weight.

(vi) For all other purposes—not more than 12% tin by weight and only secondary tin shall be used.

The total quantity of tin which any person may use in the manufacture of babbitt metal, or other similar alloys used as babbitt, during any calendar quarter, beginning January 1, 1943, shall be limited to 40% of the quantity used by him for such purposes during the base period.

(8) *Foil.* In the manufacture of foil the tin content shall be limited as follows according to the purposes for which it is to be used:

(i) Electrotypers foil—not more than 16% tin by weight.

(ii) Dental foil—not more than 30% tin by weight.

(iii) Foil to be used in condensers—not more than 4½% tin by weight.

(iv) Soft babbitt foil for the preparation of industrial metallic packing—not more than 1.5% tin by weight.

(v) Foil for any other purpose—not more than 1% tin by weight and such content shall not be derived from pig tin.

The quantity of tin which any person may use in the manufacture of foil during any calendar quarter, beginning January 1, 1943, shall be limited to 35% of the quantity used by him for such purposes during the base period.

(9) *Dairy equipment.* Tin may be used to coat fluid milk shipping containers which are manufactured within the restrictions and in accordance with the provisions of Conservation Order M-200. Tin may be used to manufacture dairy equipment other than such fluid milk shipping containers, but the total quantity used by any person in the manufacture of such other dairy equipment during any calendar quarter beginning January 1, 1943, shall be limited to the quantity used by him for such purposes during the base period. Any dairy equipment may be retinned, provided only that the amount of tin which any retinner may use during any calendar quarter, beginning January 1, 1943, for the retinning of dairy equipment, shall be limited to 150% of the quantity used by him for such purposes during the base period.

(10) *Kitchen, galley and mess equipment for the Army or Navy of the United States, the United States Maritime Commission, the War Shipping Administration or the Forest Service of the United States Department of Agriculture.* Tin may be used to coat the foregoing equipment excluding flat ware, to the extent required by the applicable specifications (including performance specifications, unless otherwise directed by the War Production Board) of the service or agency to which such equipment is to be delivered.

(11) *Wire—Coating.* Tin or tin alloys may be prepared and used for coating wire only as follows and then, only when specified:

(a) *For copper wire.* There shall be no limitation upon the tin content of the coating alloy when the copper wire to be coated therewith is of a size of .0320" nominal diameter or finer. If the wire to be coated is of a size larger than .0320" nominal diameter, the tin content of the coating alloy shall be limited to 12% tin by weight.

(b) *For steel wire.* (i) To be used as armature binding wire.

(ii) To be used in the manufacture of equipment for the production of textiles.

(iii) To be used in the packaging or marking of meat where the wire comes into actual contact with the meat.

(iv) In the liquor finishing process of fine steel bright wire.

(12) *Foundry chaplets—Coating.* Alloys containing not more than 5% of tin by weight may be manufactured and used for coating foundry chaplets. Tin in no other form may be used for such coating, except as permitted under Supplementary Order M-21-e, as amended.

(13) *Printing plates and type metal for use by the printing, publishing and related service industries.* Secondary tin only may be used in the manufacture of such plates and type metal. The quantity of secondary tin which any person may use in the manufacture of such plates and type metal during any calendar quarter, beginning January 1, 1943, shall be limited to 75% of the quantity of tin used by him for such purposes during the base period.

(14) *Dental amalgam alloys.* Tin may be used in the manufacture of dental amalgam alloys but the tin content of any such alloy shall be limited to 30% tin by weight.

(15) *Pipe organs for religious and educational institutions.* Tin may be used only in the repair or maintenance of such organs and only where and to the extent that the substitution of a less critical material is impossible.

(16) *Bolster metal for use in the manufacture of cutlery and surgical instruments for the Army or Navy of the United States, the United States Maritime Commission or the War Shipping Administration.* The tin content of such bolster metal shall not exceed 10% by weight and shall be derived from secondary tin only.

(17) *Fusible alloys and dry pipe valve seat rings.* Tin may be used in the manufacture of fusible alloys and dry pipe valve seat rings to the extent required to meet performance specifications with respect to the operation of the product in which such alloy is to be contained.

(18) *Lead-base alloys for coating sheet or wire.* Lead-base alloys containing tin may be manufactured and used to coat steel sheet or steel wire provided the tin content of any such alloy does not exceed 2.50% by weight and is not derived from pig tin.

(19) *Equipment for preparing and handling food.* In addition to the purposes specified in item (9) of this Schedule with respect to dairy products, tin may be used in the manufacture or repair of the following types of equipment, but only to the extent herein indicated:

(i) To coat or to retin articles of equipment used in the process or handling of meat in the meat-packing industry, to the extent that any such article comes into actual contact with meat. The equipment intended to be covered by this provision includes, but is not limited to: bacon combs, hangers, metal molds, shovels, forks and scoops for handling sausage and cooking utensils.

(ii) To coat or retin equipment used in the preparation or handling of any food by institutions or by industrial or commercial establishments, but only such equipment as actually comes into contact with food.

(20) *Tin pipe for use in the repair or maintenance of beverage dispensing units and parts thereof.* Tin pipe may be manufactured only for use in the repair or maintenance of beverage dispensing units and parts thereof, provided that any customer for whom such pipe is manufactured shall return to the manufacturer a quantity of used pipe equal in tin content to that of the new pipe delivered to him.

[F. R. Doc. 43-17761; Filed, November 3, 1943; 12:08 p. m.]

PART 3175—REGULATIONS APPLICABLE TO THE CONTROLLED MATERIALS PLAN

[Direction 36 to CMP Regulation 1]

CASES IN WHICH A PERSON WHO HAS RECEIVED AN ALLOTMENT FOR THE MANUFACTURE OF A CLASS B PRODUCT MAY MAKE ALLOTMENTS OR FURNISH CONTROLLED MATERIALS TO A MANUFACTURER OF THE CLASS B PRODUCT

The following direction is issued pursuant to CMP Regulation 1.

(a) *Purpose.* This direction provides an exception to the provisions of paragraph (g) (3) of CMP Regulation No. 1 which prohibits allotments of controlled materials to B product manufacturers except by the War Production Board and which, as explained in Interpretation No. 16, also prohibits a customer from furnishing controlled materials to a B product manufacturer.

(b) *Exceptions to paragraph (g) (3) of CMP Regulation No. 1.* A customer of a B product manufacturer may make allotments to the manufacturer or furnish controlled materials to him for making B products in the same way as if they were A products in either of the following cases:

(1) Where the customer has obtained an allotment or material believing, in good faith, that he would make the product himself and finds that unforeseen contingencies prevent him from doing so, or

(2) Where the customer designs and engineers a product and it is his practice to subcontract for the production of all or a portion of products which he designs and engineers and the actual manufacturer is not in a position to anticipate requirements of materials and components needed for making it.

(c) *Responsibility for preventing duplications of allotments.* A customer who wants to allot or furnish controlled materials to a supplier for the manufacture of a B product under this direction, must not do so unless he has satisfied himself that his supplier has neither applied for nor received an allotment of controlled materials needed to make the B product for him. The supplier must not accept an allotment of controlled materials from his customer if he has either applied for, or received, an allotment of controlled materials needed to make the B product for the customer.

(d) *Separate applications for B products.* Attention is called to paragraph (d) (4) of CMP Regulation No. 1 which provides that an application for an allotment must not include controlled materials needed to make Class B products which will be incorporated in the product covered by the application. This direction does not permit a customer to make allotments or furnish controlled materials to a supplier to make a B product for him except in those cases where the customer has himself received an allotment to make the product.

(e) *Records.* The customer and the supplier must maintain the usual records required for showing the receipt and use of allotments and controlled materials.

Issued this 3d day of November 1943.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

[F. R. Doc. 43-17762; Filed, November 3, 1943; 12:08 p. m.]

PART 3175—REGULATIONS APPLICABLE TO THE CONTROLLED MATERIALS PLAN

[Interpretation 21 to CMP Reg. 1]

TEMPORARY LOANS

The following interpretation is issued with respect to CMP Regulation 1:

(a) Paragraph (u) of CMP Regulation No. 1 (§ 3175.1), which places restrictions on the use of controlled materials and Class A products obtained pursuant to an allotment, does not forbid a short term "loan" of controlled materials or Class A products to another manufacturer for his use in filling an authorized production schedule. Whenever a loan is made, the consumer must make certain that the material loaned will be returned to him when he needs it. A loan for more than three months would generally be considered equivalent to a transfer of the materials and therefore unauthorized except as provided in paragraph (u). A consumer must never make such a loan when lending the material would prevent fulfillment of the consumer's authorized production schedule.

(b) A consumer borrowing controlled materials or Class A products does not have to reduce his allotment account under paragraph (v) of the regulation, relating to adjustments on account of controlled materials or Class A products obtained without use of allotments, since the loan is made on a tem-

porary basis and he must be in a position to use his allotment to return, in kind, the material borrowed.

(c) Full records of the loan transaction must be kept by both persons lending and persons borrowing.

Issued this 3d day of November 1943.

WAR PRODUCTION BOARD,
By J. JOSEPH WHELAN,
Recording Secretary.

[F. R. Doc. 43-17763; Filed, November 3, 1943; 12:08 p. m.]

Chapter XI—Office of Price Administration

PART 1404—RATIONING OF FOOTWEAR

[RO 17,[1] Amdt. 44]

SHOES

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Ration Order 17 is amended in the following respects:

1. Section 1.2 (b) is amended by adding the following: The Board shall write on the stamp the serial number of the War Ration Book from which the stamp has been detached. It shall not fill in the date of issue or date of expiration but shall write on it the number of the war ration shoe stamp being surrendered. A stamp so issued shall be valid for the same period of time as the stamp whose number is written on it.

2. Section 1.4 is amended to read as follows:

SEC. 1.4 *Consumers may get special ration in certain cases—(a) Consumers not eligible for War Ration Books may get special shoe stamps.* (1) Any individual consumer who is in the United States and who does not have and is not eligible for a War Ration Book 3, and who is not eligible for shoe rations under the next paragraph or under section 1.14 may obtain a special shoe stamp, on written application to a District Office or to a Board designated by the District Office. However, a resident of an institution of involuntary confinement may not apply if shoes are furnished him by the institution, and no consumer may apply if he has made a previous application, or has obtained a special shoe stamp, since the last war ration shoe stamp became valid. The applicant shall appear in person and a separate application shall be made for each applicant, except that an application may be made by an agent for any or all eligible consumers who are confined in an institution of involuntary confinement within the United States. The application need not be in any prescribed form, but shall contain all information needed to establish the eligibility of each applicant.

(2) In issuing a stamp under this paragraph, the District Office or Board shall write on it the words "No Book". If the stamp is issued to a resident of the United States, the District Office or Board shall not fill in either an issue date or a date of expiration but shall write on the stamp the number of the war ration stamp which last became valid for shoes. A stamp so issued shall be valid for the same period of time as the war ration shoe stamp whose number is written on it. However, if the stamp is issued to a non-resident it is valid for only 30 days from the date it is issued. When a District Office or Board issues a stamp under this paragraph to a non-resident, it shall write on it the date of issue if OPA Form R-1708 is used, or the date of expiration if OPA Form R-1708A is used.

(b) *Mexican border residents may get special shoe stamps.* (1) Any person who resides in Baja California, Mexico, within ninety kilometers of the border between Mexico and the United States, or in any other part of Mexico, within twenty kilometers of that border, may apply for special shoe stamps to enable him to acquire shoes in the United States at the rate of one pair for each period for which a war ration stamp is valid, as specified in section 1.16. The application must be made in person, on OPA Form R-183, to the Board whose office is nearest his customary point of entry into the United States or, if the applicant is unable to apply to the Board because of inadequacy of transportation, to the Customs Officer in charge of his customary point of entry. A single application must be made by the applicant for himself and for all members of his family who wish to acquire shoes. An application may be made by a person under 18 years of age only if he is the head of a household or is not a member of a family. However, anyone who can complete the application may sign or present it as agent for an applicant who is unable to appear.

(2) The application must contain or be accompanied by all information needed to establish the eligibility of all the persons for whom the application is made, and any other information called for by the form or requested by the Board or the Customs Officer. In all cases the applicant must present with his application his Non-Resident Alien's Border Crossing Identification, or passport, issued for use by the applicant, bearing a visa for entry into the United States or a notation showing that such a visa has been issued and the identification cards or passports issued for use by any of the members of his family included in the application. He must also indicate the serial number of each of them on his application.

(3) The Board, or the Customs Officer, may issue to the applicant, for each period, one special shoe stamp for each eligible person for whom the application is made, and shall insert on each stamp issued the symbol "M", the words "No Book", and the date of the commencement of the period for which the stamp is issued. Stamps so issued are valid for use by the consumer at any time until the next war ration shoe stamp becomes valid.

(c) *Special shoe stamps may be issued for prisoners of war and internees outside the United States.* (1) The nearest relative or other agent of a United States citizen or member of the armed services of the United States who is interned in a foreign country, or held as a prisoner of war by an enemy nation, may obtain a special shoe stamp from his Board to permit him to buy shoes to send to the internee or prisoner of war.

(2) The stamp may be obtained on written application to the Board, accompanied by a document showing that the person for whom the application is made is interned or held as a prisoner of war by a foreign country. If a stamp is issued on the application, the Board shall so indicate on the document supporting the application unless it is retained with the application.

(3) The Board shall write on each stamp issued the words "No Book". Stamps issued under this paragraph shall be valid for thirty days after the date of issue. If OPA Form R-1708 is used the Board shall write on it the date of issue. If OPA Form R-1708A is used it shall write on it the date of its expiration.

3. Section 1.4a is deleted.

4. Section 1.4b is deleted.

5. Section 1.4c is deleted.

6. Section 1.5 (a) is amended by deleting the first sentence and substituting the following sentence: Any person residing in the United States for a period of sixty days or more, or who is in the United States in connection with work related to the war, who needs extra shoes may get a special shoe stamp to permit him to get the extra shoes he needs.

7. Section 1.5 (c) is redesignated section 1.5 (d) and is amended by deleting the words "then being used for shoes or, if the applicant has no book" in the first sentence thereof and substituting the words "3 or, if he has none".

8. A new section 1.5 (c) is added to read as follows:

(c) If the applicant's occupation requires him to be away from home for a long period of time, in a locality where he has no access to establishments selling shoes, or in a foreign country, the Board may issue him special shoe stamps to permit him to buy the number of pairs he will need during such time. The Board will take into account any stamps he has but not those of other members of his family.

9. Section 1.6 is amended to read as follows:

SEC. 1.6. *How special shoe stamp is used.* A consumer who gets a special shoe stamp in a way permitted by this order may use it within its valid period to get one pair of shoes, but where the use to which the stamp may be put is specified on the stamp, it is not valid for any other use. Before using the stamp the consumer must write on it the serial number of his War Ration Book 3, or, if he has none, the words

---

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 1749, 2040, 2487, 2943, 3315, 3371, 3951, 4129, 3948, 4716, 5589, 5678, 5679, 5867, 5756, 6046, 6687, 7198, 7261, 8060, 8064, 8357, 8601, 9062, 9423, 9567, 9884, 10269, 11445, 11515, 12026, 12137, 12180, 12547, 12548, 12515, 13128.

"No Book" unless the serial number of a War Ration Book or the words "No Book" are already written on the stamp. If a serial number is written on a stamp the consumer must show the War Ration Book having the same serial number to the person to whom he gives the stamp, except when he sends it with a mail order.

10. Section 1.7 is amended by adding a new section heading which reads as follows: *Employers, institutions, and recreational facilities:* by designating the former section heading as the paragraph heading of paragraph (a); by redesignating the former paragraphs (a), (b), (c), and (d) as sub-paragraphs (1), (2), (3), and (4), respectively; by deleting the words "under this section" in the first sentence of sub-paragraph (2) and by substituting the following for the last sentence of sub-paragraph (1): "If a special shoe stamp is issued, the District Office will write on it the words "No Book". If OPA Form R–1708 is used, the District Office shall write on it the date of its issue. If Form R–1708A is used, it shall write on it the date of its expiration. A stamp so issued shall be valid for thirty days from its date of issue.

11. Section 1.7a and the heading thereof are redesignated as section 1.7 (b); paragraphs (a) and (b) thereof are redesignated sub-paragraphs (1) and (2) respectively; and the figure "3" is added after the words "War Ration Book" wherever they appear in the third sentence of sub-paragraph (2).

12. Section 1.7b and the heading thereof are redesignated as 1.7 (c); paragraphs (a), (b), and (c) thereof are redesignated sub-paragraphs (1), (2), and (3), respectively; and the words "paragraph (a) or (b)" in the first sentence of sub-paragraph (3) are changed to read "sub-paragraph (1) or (2)".

13. Section 1.10 (a) is amended by deleting the second and third sentences.

14. Section 1.10 (c) is added to read as follows: (c) In issuing a stamp under this section the establishment or Board shall not fill in either an issue date or a date of expiration but shall write on the stamp, the number of the war ration stamp which last became valid for shoes. A stamp so issued shall be valid for the same period of time as the war ration shoe stamp whose number is written on it.

15. Section 1.15 is amended by deleting the words "date of issue" in the second sentence and substituting the words "time of issue or the time of expiration either by reference to a date or a war ration shoe stamp"; and by adding at the end of the second sentence the words "or the words 'No Book'."

16. Section 2.9 is amended by deleting paragraph (c) and by amending paragraph (a) to read as follows:

(a) *Time for depositing is limited.* A stamp or certificate may not be deposited to an establishment's account later than 30 days after its expiration for consumer use. A ration check may be deposited at any time. A certificate is valid for consumer use for 30 days after the date of issue. A special shoe stamp is valid for consumer use as follows:

(1) If the stamp shows a time of issue or expiration only by describing a war ration shoe stamp it is valid until the expiration of that war ration stamp;

(2) If the stamp contains an expiration date, it is valid through the stated expiration date;

(3) If the stamp contains an issue date, it is valid for 30 days thereafter or, if issued to a Mexican border resident under section 1.4 (b), until the next war ration shoe stamp becomes valid.

17. Section 2.10 (a) is amended to read as follows:

(a) An establishment that is unable to fill a consumer's order for which it has received valid ration currency, and an establishment making a refund for returned shoes as permitted by section 1.10 (a), must return to the consumer a special shoe stamp as a refund for the currency or shoes received. War ration shoe stamps may not be used for refund purposes. Where an establishment is able to fill a consumer's order, but does not do so, it may return a special shoe stamp to the consumer if it has received valid ration currency for the order. In issuing a stamp under this section the establishment shall not fill in either an issue date or a date of expiration but shall write on the stamp, the number of the war ration stamp which last became valid for shoes. A stamp so issued shall be valid for the same period of time as the war ration shoe stamp whose number is written on it. The establishment may get special shoe stamps for this purpose from its Board, in exchange for a certified ration check drawn to the account of the Office of Price Administration or in exchange for valid shoe stamps or certificates received from customers.

This amendment shall become effective November 9, 1943.

(Pub. Law 671, 76th Cong., as amended by Pub. Laws 89, 421, and 507, 77th Cong.; WPB. Dir. 1, 7 F.R. 562, Supp. Dir. 1–T, 8 F.R. 1727; E.O. 9125, 7 F.R. 2719)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43–17724; Filed, November 2, 1943; 5:04 p. m.]

PART 1405—FERRO ALLOYS

[MPR 489]

TUNGSTEN, MOLYBDENUM, VANADIUM, COBALT, AND CERTAIN OTHER ALLOYS AND METALS

In the judgment of the Price Administrator it is necessary and proper to establish maximum prices for sales of tungsten, molybdenum, vanadium, cobalt, and certain other alloys and metals by a specific maximum price regulation. The Price Administrator has ascertained and given due consideration to the prices of tungsten, molybdenum, vanadium, cobalt, and certain other alloys and metals covered by this regulation prevailing between October 1 and October 15, 1941, and has made adjustments for such relevant factors as he has determined and deemed to be of general applicability. So far as practicable, the Price Administrator has advised and consulted with representative members of the industries which will be affected by this regulation.

In the judgment of the Price Administrator the maximum prices established by this regulation are and will be generally fair and equitable and will effectuate the purposes of the Emergency Price Control Act of 1942, as amended. A statement of the considerations involved in the issuance of this regulation is issued simultaneously herewith and has been filed with the Division of the Federal Register.*

Such specifications and standards as are used in this regulation were, prior to such use, in general use in the trade or industry affected.

§ 1405.154 *Maximum prices for tungsten, molybdenum, vanadium, cobalt, and certain other alloys and metals.* Under the authority vested in the Price Administrator by the Emergency Price Control Act of 1942, as amended, and Executive Order No. 9250 and 9328, Maximum Price Regulation No. 489 (Tungsten, Molybdenum, Vanadium, Cobalt, and Certain Other Alloys and Metals), which is annexed hereto and made a part hereof, is hereby issued.

AUTHORITY: § 1405.154 issued under Pub. Laws 421 and 729, 77th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681.

MAXIMUM PRICE REGULATION 489—TUNGSTEN, MOLYBDENUM, VANADIUM, COBALT, AND CERTAIN OTHER ALLOYS AND METALS

CONTENTS

SECTION 1. *Maximum prices for tungsten*—(a) *Ferrotungsten.* The maximum prices for ferrotungsten shall be determined by using the maximum base prices and premiums, where applicable, set out below:

* Copies may be obtained from the Office of Price Administration.

(1) *Analysis of standard grade.*

	Percent
Tungsten	70–82
Carbon, maximum	0.60
Phosphorus, maximum	0.10
Sulphur, maximum	0.10
Silicon, maximum	1.00
Manganese, maximum	0.75
Copper, maximum	0.10
Arsenic, maximum	0.10
Antimony, maximum	0.08
Tin, maximum	0.20
Sum of tin, copper, arsenic, phosphorus, and sulphur, maximum	0.45

(2) *Maximum base prices for standard grade ferrotungsten.* The maximum prices per pound of contained tungsten for standard grade ferrotungsten, lump or ¼ X down, packed, f. o. b. producer's plant at Niagara Falls, New York, Washington, Pa., or York, Pa., shall be:

10,000 pounds or more	$1.90
2,000 to 10,000 lbs	2.00
100 to 2,000 lbs	2.10
Less than 100 lbs	2.15

(3) *Premiums*—(i) *Crushing to a specified mesh.* The highest premium for crushing to a specified mesh size which the seller charged during January, February or March 1942, may be added to the above prices. (This does not apply to ¼ X down.)

(ii) *Special analysis.* Premiums not exceeding 25 cents per pound of contained tungsten may be added to the above base prices for ferrotungsten of special analysis. By "special analysis" is meant an analysis varying substantially from the analysis for the standard grade, set forth above, and supplied at the request of and for the convenience of the buyer.

(b) *Other tungsten products.* The maximum prices for the tungsten products listed below shall be, except as otherwise provided in section 11, (1) the highest prices charged for such products by a seller on a delivery made during January, February or March 1942 to a purchaser of the same class, or (2) if the seller cannot make this determination on the basis of a delivery, the highest prices which the seller quoted for delivery of such products during January, February or March 1942 to a purchaser of the same class.

If the seller cannot determine his maximum prices under either of the above provisions, his maximum price shall be subject to the approval of the Administrator, as set forth in section 7 of this regulation.

The following tungsten products are covered by this paragraph:

Tungsten metal powder
Tungsten carbide powder
Tungstic acid
Tungstic oxide
Ammonium para-tungstate
Sodium tungstate
Calcium tungstate
Other alloys and compounds of tungsten which are consumed principally by the metallurgical industry.

(c) *Tungsten ores and concentrates.* Tungsten ores and concentrates are exempt from the provisions of this regulation and the General Maximum Price Regulation.

N. B.: For general terms see section 8 below.

SEC. 2. *Maximum prices for molybdenum*—(a) *Ferromolybdenum, molybdic oxide and calcium molybdate.* The maximum prices per pound of contained molybdenum for any quantity of ferromolybdenum, molybdic oxide and calcium molybdate suitable for steel or iron manufacture, packed, f. o. b. producer's plant shall be:

Ferromolybdenum	$0.95
Molybdic oxide, technical (powder or briquettes)	.80
Calcium molybdate	.80

(b) *Other molybdenum products.* The maximum prices for the molybdenum products listed below shall be, except as otherwise provided in section 11, (1) the highest prices charged for such products by a seller on a delivery made during January, February or March 1942 to a purchaser of the same class, or (2) if the seller cannot make this determination on the basis of delivery, the highest prices which the seller quoted for delivery of such products during January, February or March 1942 to a purchaser of the same class.

If the seller cannot determine his maximum prices under either of the above provisions, his maximum price shall be subject to the approval of the Administrator, as set forth in section 7 of this regulation.

The following molybdenum products are covered by this paragraph:

Molybdenum metal powder.
Molybdenum carbide powder.
Molybdic acid
Molybdenum trioxide
Molybdenum silicide
Sodium molybdate
Ammonium molybdate
Other molybdenum alloys and compounds which are consumed principally by the metallurgical industry.

(c) *Molybdenum ores and concentrates.* Molybdenum ores and concentrates are exempt from the provisions of this regulation and the General Maximum Price Regulation.

N. B.: For general terms see section 8 below.

SEC. 3. *Maximum prices for vanadium*—(a) *Ferrovanadium.* The maximum prices per pound of contained vanadium for standard crushed sizes of the grades and analysis of ferrovanadium shown, in any quantity, f. o. b. Niagara Falls, N. Y. or Bridgeville, Pa. with freight allowed to destination on quantities of 25 pounds or over, up to but not in excess of the freight rates from the basing point to St. Louis, Missouri, shall be determined by using the following maximum base prices and premiums where applicable:

(1) *Maximum base prices:*

Grade	Analysis			Prices	
	Percent V (minimum)	Percent Si (maximum)	Percent C (maximum)	Contract	Spot
A—Open hearth	30	12.00	3.50	$2.70	$2.80
B—Crucible	35	4.00	1.00	2.80	2.90
C—Primos	35	1.50	.20	2.90	3.00

(2) *Premiums for crushing.* The standard crushing sizes for all grades of ferrovanadium are from lump size down to and including 20 mesh X down. Premiums per pound of contained vanadium may be added to the above base prices for crushing or grinding to smaller sizes as follows:

Quantity	48 mesh X down	65 to 100 mesh X down	150 or 200 mesh X down
Carload lots	$0.03	$0.04	$0.05
Ton lots	.04	.06	.08
Less than ton lots to 200 lbs	.06	.10	.12
Less than 200 lbs	.10	.20	.25

(b) *Vanadium pentoxide.* The maximum prices per pound of contained V_2O_5 for air dried or fused vanadium pentoxide, f. o. b. Niagara Falls, N. Y. or Bridgeville, Pa., with freight allowed to destination on quantities of 25 pounds or over, up to but not in excess of the freight rate from the basing point to St. Louis, Missouri, shall be determined by using the following maximum base prices and premiums, where applicable:

(1) Maximum base contract price, any quantity	$1.10
(2) Maximum base spot price:	
500 lbs. and over	1.15
Less than 500 lbs. to 10 lbs	1.20
Under 10 lbs	1.25

(3) *Premiums for crushing.* The standard crushed size for air dried vanadium pentoxide is powdered, and standard crushed sizes for fused vanadium pentoxide are ¾" X down, ½" X down and ¼" X down. Premiums per pound of V_2O_5 contained may be added to the above base prices for crushing or grinding to smaller sizes as follows:

Quantities	8 mesh X down	20 mesh X down
Ton lots	$0.015	$0.0175
Less than tons down to 200 lbs	.02	.03
Less than 200 lbs	.03	.04

(c) *Other vanadium products.* The maximum prices for the vanadium products listed below shall be, except as otherwise provided in section 11, (1) the highest prices charged for such products by a seller on a delivery made during January, February or March 1942 to a purchaser of the same class, or (2) if the seller cannot make this determination on the basis of a delivery, the highest prices which the seller quoted for delivery of such products during January, February or March 1942 to a purchaser of the same class.

If the seller cannot determine his maximum prices under either of the above provisions, his maximum price shall be subject to the approval of the Administrator, as set forth in section 7 of this regulation.

The following vanadium products are covered by this paragraph:

Vanadium metal
Vanadium metal powder
Vanadium silicide
Vanadium chloride
Sodium ortho vanadate
Ammonium meta vanadate

Other vanadium alloys and compounds which are consumed principally by the metallurgical industry.

(d) *Vanadium ores and concentrates.* Vanadium ores and concentrates are exempt from the provisions of this regulation and the General Maximum Price Regulation.

N. B.: For general terms see section 8 below.

SEC. 4. *Maximum prices for cobalt—*(a) *Cobalt metal sold to a metallurgical user.* The maximum price per pound of cobalt metal containing a minimum of 97% cobalt, packed f. o. b. producer's plant, with freight allowed to destination on quantities of 25 pounds or more, up to but not in excess of the freight rate from producer's plant to Chicago, Illinois, shall be as follows when sold to a metallurgical user:

	Contract	Spot
Kegs, 500 to 550 lbs.	$1.50	$1.60
Cases, 100 lbs.	1.52	1.62
Less than 100 lbs.	1.57	1.67

For the purposes of this section "metallurgical user" means a person whose principal use of cobalt metal is in the production of steels, carbides and ferrous or non-ferrous alloys.

(b) *Other cobalt products and cobalt metal sold to other users.* The maximum prices for the cobalt products listed below, and for cobalt metal sold to persons other than metallurgical users, shall, be, except as otherwise provided in section 11, (1) the highest prices charged for such products or metal by a seller on a delivery made during January, February or March 1942 to a purchaser of the same class, or (2) if the seller cannot make this determination on the basis of a delivery, the highest prices which the seller quoted for delivery of such products during January, February, or March 1942 to a purchaser of the same class.

If the seller cannot determine his maximum prices under either of the above provisions, his maximum price shall be subject to the approval of the Administrator, as set forth in section 7 of this regulation.

The following cobalt products are covered by this paragraph:

Cobalt metal fines
Cobalt metal powder
Cobalt oxides
Other alloys and compounds of cobalt which are consumed principally by the metallurgical industry.

(c) *Cobalt ores, concentrates and crudes.* Cobalt ores, concentrates and crudes are exempt from the provisions of this regulation and the General Maximum Price Regulation.

N. B.: For general terms see section 8 below.

SEC. 5. *Maximum prices for ferrophosphorus.* (a) The maximum prices for ferrophosphorus shall be determined by using the maximum base prices and premiums, where applicable, set out below:

(1) *Analysis:*

	17-19% Grade	23-26% Grade
Phosphorus	Base, 18%; range, 17-19%.	Base, 24%; range, 23-26%.
Iron	Approx. 79%	Approx. 70%.

(2) *Maximum base prices.* The maximum prices for ferrophosphorus based on the gross weight of the material, f.o.b. producer's plant shall be:

Quantity	17-19% Grade	23-26% Grade
	Per gross ton	*Per gross ton*
Carload lots, bulk	$58.50	$75.00
Carload lots, packed	63.00	79.50
Less than carload lots down to 3 gross tons, packed	76.50	93.50
3 gross tons to 1 gross ton, packed	81.50	100.00
	Per lb.	*Per lb.*
1 gross ton down to 500 lbs., packed	.05	.065
500 lbs. down to 100 lbs., packed	.06	.07
Less than 100 lbs., packed	.08	.10

(3) *Premiums.* To the above base prices may be added the following premiums: (1) For crushing to egg size or smaller—$10.00 per gross ton in gross ton lots or over; and $0.005 per pound in less than gross ton lots. (2) For phosphorous content in excess of the base analysis—$3.00 per gross ton on gross ton lots or over for each 1% of phosphorus, fractions prorated.

(4) *Penalty.* For phosphorus content lower than the base analysis deduct $3.00 per gross ton on gross ton lots or over for each 1% of phosphorus, fraction prorated.

SEC. 6. *Maximum prices for certain special alloys and metals.*—(a) *Simanal.* The maximum prices for simanal shall be determined by using the maximum base prices and premiums, where applicable, set out below:

(1) Analysis:

	Percent Approximate
Silicon	20
Manganese	20
Aluminum	20
Balance being principally iron	

(2) *Maximum base contract prices.* The maximum prices per pound of material, gross weight, f. o. b. producer's plant with freight allowed to destination, up to but not in excess of the freight rate from producer's plant to St. Louis, Missouri, shall be:

	Lump	2" X D	1" X D	½" X D	¼" X D	8M X D	20M X D
Carload (bulk)	$0.0950	$0.0950	$0.0950	$0.0975	$0.0975	$0.1000	$0.1025
Ton lots (packed 50 gal. barrels)	.1000	.1025	.1025	.1050	.1050	.1075	.1100
Less than ton lots (packed 50 gal. barrels)	.1050	.1100	.1100	.1125	.1125	.1125	.1200

(3) *Premiums.* (i) To the above base prices may be added a premium of $0.005 per pound for spot sales.

(ii) For packing ton lots or less in 25 gal. barrels a premium of $0.0050 per pound may be added.

(b) *Alsifer.* The maximum prices for alsifer shall be determined by using the maximum base prices and premiums, where applicable, set out below:

(1) *Analysis:*

	Percent approximately
Aluminum	20
Silicon	40
Iron	40

(2) *Maximum base contract prices.* The maximum prices per pound of material, gross weight, f. o. b. Suspension Bridge, N. Y. shall be:

Carload lots (bulk or packed)	$0.0750
Ton lots (packed)	.0800
Less than ton lots (packed)	.0850

(3) *Premium.* To the above base prices may be added a premium of $0.0050 per pound for spot sales.

(c) *Calcium metal.* The maximum prices for calcium metal shall be determined by using the maximum base prices and premiums, where applicable, set out below:

(1) *Maximum base contract prices.* The maximum prices per pound of metal, packed, f. o. b. Sault Ste. Marie, Michigan, with freight allowed to Mississippi River points and all the area east of the Mississippi River shall be:

	Casts	Turnings
2,000 pounds or more	$1.80	$2.30
Less than 2,000 lbs.	2.30	2.80

(2) *Premium.* To the above base prices may be added a premium of $0.05 per pound for spot sales.

(d) *Calcium silicon.* The maximum prices for calcium silicon shall be determined by using the maximum base prices and premiums, where applicable, set out below:

(1) *Analysis:*

	Percent
Calcium, approximate	30-35
Silicon, approximate	60-65
Iron, maximum	3.50
or	
Calcium, approximate	28-32
Silicon, approximate	60-65
Iron, maximum	6.00

(2) *Maximum base contract prices.* The maximum prices per pound of material, gross weight, f. o. b. Niagara Falls, N. Y., with freight allowed to destination up to but not in excess of the freight rate from Niagara Falls, N. Y. to St. Louis, Missouri, shall be:

	Lump 25# X 2"	2" X D	1" X D	¼" X D	8M X D
Carload lots	$0.1300	$0.1400	$0.1400	$0.1400	$0.1400
Gross ton lots	.1450	.1550	.1550	.1550	.1550
200 lbs. to gross ton	.1550	.1650	.1650	.1650	.1650
Less than 200 lbs.	.1600	.1700	.1700	.1700	.1700

(3) *Premium.* To the above base prices may be added a premium of $0.0025 per pound for spot sales.

(e) *Calcium-manganese-silicon.* The maximum prices for calcium-manganese-silicon shall be determined by using the maximum base prices and premiums, where applicable, set out below:

(1) *Analysis:*

	Percent range
Calcium	16–20
Manganese	14–18
Silicon	53–59

Balance principally iron.

(2) *Maximum base contract prices.* The maximum prices per pound of material, gross weight, f. o. b. Niagara Falls, N. Y., with freight allowed to destination up to but not in excess of the freight rate from Niagara Falls, N. Y. to St. Louis, Mo., shall be:

	Lump 25# X D	2" X D
Carload lots	$0.1550	$0.1550
Gross ton lots	.1650	.1650
200 lbs. up to gross ton	.1700	.1700
Less than 200 lbs	.1750	.1750

(3) *Premium.* To the above base prices may be added a premium of $0.0025 per pound for spot sales.

(f) *Other special alloys and metals.* The maximum prices for the special alloys and metals listed below shall be, except as otherwise provided in section 11, (1) the highest prices charged for such products by a seller on a delivery made during January, February or March 1942 to a purchaser of the same class, or (2) if the seller cannot make this determination on the basis of a delivery, the highest prices which the seller quoted for delivery of such products during January, February or March 1942 to a purchaser of the same class.

If the seller cannot determine his maximum prices under either of the above provisions, his maximum price shall be subject to the approval of the Administrator, as set forth in section 7 of this regulation.

The following products are covered by this paragraph:

Borosil	Manganese boron
Bortam	Silcaz
Ferroboron	Silvaz
Ferromanganese-silicon	SMZ alloy
Grainal alloys	

Other alloys and compounds consumed principally by the metallurgical industry, in which boron, calcium, chromium, manganese, phosphorus, or silicon accounts for a larger part of the material cost than any other constituent element. This provision, however, does not apply to any material covered by any other section of this regulation, or by Revised Maximum Price Regulation #138[1] (Ferromanganese and Manganese Alloys and Metals), Maximum Price Regulation # 405[2] (Ferrosilicon and Silicon Metal) and Maximum Price Regulation #407[3] (Ferrochromium and Chromium Metal).

N. B. For general terms see section 8 below.

[1] 8 F.R. 8864, 10762.
[2] 8 F.R. 8181, 10579.
[3] 8 F. R. 8075, 8550, 9024.

SEC. 7. *Maximum prices for types, grades and sizes of alloys and metals for which maximum prices cannot be established by sections 1 through 6 of this regulation.* If the seller of any type, grade or size of alloy or metal listed in this regulation cannot determine his maximum prices under the provisions of sections 1 through 6, inclusive, he shall submit his proposed maximum price for the approval of the Administrator. This price and an analysis of the material shall be reported within 15 days after delivery and, pending approval, such price may be paid and received subject to adjustment between the parties if the price is disapproved. A price once reported and approved need not thereafter be reported by the same seller.

Reports called for by this provision shall be made by letter addressed to the Non-Ferrous Metals Branch, Office of Price Administration, Washington, D. C. In approving or disapproving a price submitted for approval, the Office of Price Administration will consider whether the price submitted is in line with other maximum prices established by this regulation.

SEC. 8. *Terms of general applicability*—(a) *Credit.* No charge shall be made for extension of credit when payment is made within 30 days of date of invoice.

(b) *No spot premiums on sales to the United States or any agency thereof.* No spot premium may be added on any sale or delivery to the United States or any agency thereof of tungsten, molybdenum, vanadium, cobalt or any of the other alloys or metals covered by this regulation.

SEC. 9. *Exemption of sales for laboratory and experimental purposes.* Sales of tungsten, molybdenum, vanadium, cobalt, and the other alloys and metals covered by this regulation shall be exempt from this regulation and the General Maximum Price Regulation when such sales are made for laboratory and experimental uses. For the purpose of this section "sales for laboratory and experimental purposes" means sales of relatively small amounts used for testing, research, sampling or experimental use and covers alloys, metals and compounds already being produced commercially, as well as those produced experimentally and in the process of development.

SEC. 10. *Sales by independent warehousemen.* The maximum price at which an independent warehouseman may sell tungsten, molybdenum, vanadium, cobalt or any of the other alloys or metals covered by this regulation shall be the maximum price at which the quantity and grade sold by him could be sold by a producer for delivery to his warehouse, plus the following differentials or premiums:

	Percent
500 lbs. and over	10
Less than 500 lbs. down to 100 lbs.	15
100 lbs. and less	20

The maximum price for independent warehousemen is f. o. b. warehouse with no allowance for freight.

For the purpose of this section "independent warehouseman" means a private seller, other than a manufacturer of tungsten, molybdenum, vanadium, cobalt and other alloys and metals or a subsidiary or affiliate thereof, who renders the service of maintaining a stock of tungsten, molybdenum, vanadium, cobalt, or other alloys or metals for the convenience of buyers who desire to purchase small quantities or to receive quick delivery.

SEC. 11. *Maximum prices for certain sellers.* (a) Cleveland Tungsten, Inc., Cleveland, Ohio, may sell or deliver, and any person may buy or receive from Cleveland Tungsten, Inc. tungsten metal powder, containing a minimum of 99.7% tungsten and a maximum of .20% alkalis and .02% molybdenum, at a price not in excess of $5.40 per pound f. o. b. seller's plant.

(b) The S. W. Shattuck Chemical Company of Chicago, Illinois, may sell and deliver, and any person may buy and receive in the course of trade or business from the S. W. Shattuck Chemical Company, technical grade tungstic oxide (WO_3) at a price not in excess of $2.58 per pound delivered.

SEC. 12. *Applicability of regulation*—(a) *Geographical.* The maximum prices established by this regulation shall apply to the forty-eight states and the District of Columbia.

(b) *Export sales.* The maximum price at which any person may export tungsten, molybdenum, vanadium, cobalt or any other alloy or metal covered by this regulation shall be determined in accordance with the provisions of the Second Revised Maximum Export Regulation,[4] issued by the Office of Price Administration.

(c) *Import sales and sales of imported tungsten, molybdenum, vanadium, cobalt, and other alloys and metals.* Neither this regulation nor the General Maximum Price Regulation[5] shall apply to the importation of tungsten, molybdenum, vanadium, cobalt, and the other alloys and metals listed in this regulation. This regulation shall apply, however, to the sale of all tungsten, molybdenum, vanadium, cobalt, and other alloys and metals listed in this regulation after they shall have been imported into the forty-eight states and the District of Columbia.

(d) *Relation to General Maximum Price Regulation.* This regulation supersedes the General Maximum Price Regulation as to sales and deliveries which are covered by, or expressly excluded from, this regulation.

SEC. 13. *Records and reports.* (a) On and after November 8, 1943, every person making a purchase or sale of tungsten, molybdenum, vanadium, cobalt, and other alloys and metals covered by this regulation shall keep for inspection by the Office of Price Administration, for so long as the Emergency Price Control Act of 1942 remains in effect, complete and accurate records of each such purchase

[4] 8 F.R. 4132, 5987, 7662, 5987, 9998.
[5] 8 F.R. 3096, 3449, 4347, 4486, 4724, 4848, 4974, 6047, 6962, 8511, 9025, 9991, 11955, 13724.

or sale showing (1) the date thereof, (2) the name and address of the buyer and the seller, (3) the quantity and analysis of each grade and size purchased or sold, (4) the date of delivery of each shipment, and (5) the price paid or received. The invoice or any other customary record containing the required data may be retained for the purposes of this section.

(b) Persons subject to this regulation shall submit such reports, subject to the approval of the Bureau of the Budget in accordance with the Federal Reports Act of 1942, as the Office of Price Administration may from time to time require.

SEC. 14. *Adjustable pricing.* Any person may agree to sell at a price which can be increased up to the maximum price in effect at the time of delivery; but no person may, unless authorized by the Office of Price Administration, deliver or agree to deliver at prices to be adjusted upward in accordance with action taken by the Office of Price Administration after delivery. Such authorization may be given when a request for a change in the applicable maximum price is pending, but only if the authorization is necessary to promote distribution or production and if it will not interfere with the purposes of the Emergency Price Control Act of 1942, as amended. The authorization may be given by the Administrator or by any official of the Office of Price Administration to whom the authority to grant such authorization has been delegated. The authorization will be given by order, except that it may be given by letter or telegram when the contemplated revision will be the granting of an individual application for adustment.

SEC. 15. *Applications for adjustment—* (a) *When available.* The Office of Price Administration will adjust any maximum price established by this regulation whenever it finds, from an application for adjustment or on its own motion, that the price impedes or threatens to impede any seller's production of any commodity and that the seller's production is necessary for essential war or civilian purposes.

(b) *Considerations.* In considering whether production is impeded or threatened, among other factors, consideration will be given to: (1) costs of and revenue from the commodity in question; (2) the relative importance of the commodity in the seller's overall business; (3) the profitableness of the seller's business; and (4) any special facts which the seller calls to the attention of the Office of Price Administration.

(c) *Amount of adjustment.* Increase in price will be permitted in an amount which the Office of Price Administration considers sufficient to avoid the impeding of production or the threat of impeding production.

(d) *Form of application.* An original and one copy of an application for adjustment must be filed with the Office of Price Administration, Washington, D. C. It is suggested that, before filing an application for adjustment under the provisions of this section, the seller obtain from the Non-Ferrous Metals Branch, Office of Price Administration, Washington, D.C., a statement of the specific information that will be necessary in order that his application may receive prompt action.

SEC. 16. *Petitions for amendment.* Any person seeking an amendment of any provision of this regulation may file a petition for amendment in accordance with the provisions of the Revised Procedural Regulation No. 1,[6] issued by the Office of Price Administration.

SEC. 17. *Prohibition against dealing in tungsten, molybdenum, vanadium, cobalt, ferrophosphorus and other alloys and metals at prices above maximum.* (a) On and after November 8, 1943, regardless of any contract, agreement, or other obligation, no person shall sell or deliver tungsten, molybdenum, vanadium, cobalt, ferrophosphorus or any other alloys or metals covered by this regulation and no person in the course of trade or business shall buy or receive tungsten, molybdenum, vanadium, cobalt, ferrophosphorus or any other alloys or metals covered by this regulation at prices higher than the maximum prices set out in this regulation; and no person shall agree, offer, solicit, or attempt to do any of the foregoing.

(b) Any practice or device which is an attempt to get the effect of a price higher than the maximum without actually charging a higher price is prohibited and is as much a violation of this regulation as an outright excessive price. This applies to devices involving commissions, services, transportation arrangements, premiums, special privileges, tying-agreements, trade understandings and the like.

(c) Prices lower than those set out in this regulation may be charged, demanded, paid or offered.

SEC. 18. *Enforcement.* (a) Persons violating any provision of this regulation are subject to the criminal penalties, civil enforcement actions and suits for treble damages provided for by the Emergency Price Control Act of 1942, as amended.

(b) No war procurement agency, nor any contracting or paying finance office thereof, shall be subject to any liability, civil or criminal, imposed by this regulation or the Emergency Price Control Act of 1942, as amended. "War procurement agency" includes the War Department, the Navy Department, the United States Maritime Commission and the Lend-Lease Section in the Procurement Division of the Treasury Department, or any agency of the foregoing.

SEC. 19. *Licensing.* The provisions of Licensing Order No. 1, licensing all persons who make sales under price control, are applicable to all sellers subject to this regulation. A seller's license may be suspended for violation of the license or of any one or more maximum price regulations. A person whose license is suspended may not, during the period of suspension, make any sale for which his license has been suspended.

SEC. 20. *Definitions.* (a) When used in this regulation the term:

(1) "Person" includes an individual, corporation, partnership, association, or any other organized group of persons, or legal successor or representative of any of the foregoing, and includes the United States or any agency thereof, or any other government or any of its political subdivisions, or any agency of any of the foregoing.

(2) "Purchaser of the same class" refers to the practice adopted by the seller in setting different prices for sales to different purchasers or kinds of purchasers or for purchasers located in different areas or for different quantities or grades or under different conditions of sale.

(3) "Contract price" means that price determined by a written contract calling for delivery or deliveries of an estimated amount at some future date or dates within a specified period of time, not less than three months.

(4) "Gross ton" means 2,240 pounds.

(5) "Spot price" means the price for a single or isolated sale for delivery within three months.

(6) "Carload lots" means not less than the minimum quantity which may be shipped by the seller to the particular buyer at the carload tariff rate.

(7) "Freight" means the charge for transportation not in excess of the charge made by railroads and includes the federal tax on such railroad transportation charge.

(8) "Tungsten" means any one of the materials which are specifically listed in section 1 and any other alloy or compound of tungsten which is consumed principally by the metallurgical industry.

(9) "Molybdenum" means any one of the materials which are specifically listed in section 2 and any other alloy or compound of molybdenum which is consumed principally by the metallurgical industry.

(10) "Vanadium" means any one of the materials which are specifically listed in section 3 and any other alloy or compound of vanadium which is consumed principally by the metallurgical industry.

(11) "Cobalt" means any one of the materials which are specifically listed in section 4 and any other alloy or compound of cobalt which is consumed principally by the metallurgical industry.

(12) "Ferrophosphorus" means an alloy of phosphorus as described in section 5.

(13) "Other alloys and metals" means any of the materials covered in section 6.

(14) "Alloy of compound of a particular element" (as tungsten) means an alloy or compound, consumed principally by the metallurgical industry, in which the particular element accounts for a larger part of the material cost than any other constituent element.

(15) "Metallurgical industry" means the group of industries which produce metals, steels, carbides and ferrous and non-ferrous alloys.

(b) Unless the context otherwise requires, the definitions set forth in section 302 of the Emergency Price Control Act of 1942 shall apply to other terms used in this regulation.

[6] 7 F.R. 8961; 8 F.R. 3313, 3533, 6173, 11806.

This regulation shall become effective November 8, 1943.

NOTE: All reporting and record-keeping requirements of this regulation have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17725; Filed, November 2, 1943; 5:05 p. m.]

PART 1440—PROCESSED FOOD COMMODITIES

[MPR 488]

PICKLES AND CERTAIN PICKLED PRODUCTS

This regulation is issued to establish maximum prices for pickles (except fresh cucumber pickles) and for certain pickled products, and to aid in stabilizing the cost of living.

A statement of the considerations involved in the issuance of this regulation has been issued and filed with the Division of the Federal Register.*

§ 1440.53 *Maximum prices for pickles and certain pickled products.* Under the authority vested in the Price Administrator by the Emergency Price Control Act of 1942, as amended, and Executive Orders No. 9250 and 9328, Maximum Price Regulation No. 488 (Pickles and Certain Pickled Products), which is annexed hereto and made a part hereof, is hereby issued.

AUTHORITY: § 1440.53 issued under 56 Stat. 23, 765; Pub. Law 151: 78 Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681.

MAXIMUM PRICE REGULATION NO. 488—PICKLES AND CERTAIN PICKLED PRODUCTS

CONTENTS

SECTION 1. *Explanation of the regulation.* (a) This regulation establishes maximum prices for sales of salt stock; processed pickles; processed finger peppers; processed cherry peppers; processed cauliflower; processed onions; relish; and picalilli. (These products will be referred to as "listed commodities.") It does not apply to sales of fresh cucumber pickles.

(b) This regulation applies to sales of the listed commodities by all persons except wholesalers and retailers (as defined in Maximum Price Regulations Nos. 421,[1] 422[2] and 423[3]). Wagon wholesalers, however, are included.

(c) This regulation applies to the 48 states of the United States and the District of Columbia, but it does not apply to export sales. (See Second Revised Maximum Export Price Regulation.[4])

(d) This regulation becomes effective on November 2, 1943.

SEC. 2. *Definitions.* (a) When used in this regulation, the term:

(1) "Salt stock" means raw cucumbers, cauliflowers, peppers, or onions which have been fully or partially cured by treatment with salt brine, and which are not ready for human consumption.

(2) "Processed" means converted by processing from salt stock to the finished product, packed and ready for human consumption.

(3) "Salter" or "briner" means a person who converts raw stock into salt stock.

(4) "Final processor" means a person who, by processing, converts brine or salt stock into the finished product packed and ready for human consumption.

(5) "Relish" and "picalilli" are products consisting of a mixture of some or all of the following cut and processed vegetables: cucumbers, green tomatoes, onions, celery, white cabbage, cauliflower, peppers and spices.

(6) "Wagon wholesaler" means a wholesaler who purchases the product being priced and distributes it to retail stores or to commercial, industrial, or institutional users from an inventory stocked in trucks or other conveyances which are under the supervision of driver-salesmen who make deliveries at the time and point of sale.

(7) "Item" means any kind, brand, grade, variety, count, style of pack, container type and size, of the listed commodities.

(b) Unless the context otherwise requires, the definitions set forth in section 302 of the Emergency Price Control Act of 1942, as amended, shall apply to other terms used herein.

SEC. 3. *General pricing method.* (a) The pricing method of this paragraph applies to salters and briners, final processors, and wagon wholesalers. For each item of the listed commodities, the seller's maximum price to any class of purchasers shall be his maximum price under any provision of or supplement to the General Maximum Price Regulation, plus the following increase:

(1) For salters and briners,

(i) On sales of cucumbers, 25 cents per bushel.

(ii) On sales of cauliflower, onions and pepper hulls, 20% of the 1942 cost of the raw vegetable. "1942 cost" means the total amount paid for the particular vegetable divided by the total number of bushels (or other selling unit for which a price is being determined) purchased in 1942.

(2) For final processors, 5% of the maximum price under the General Maximum Price Regulation.

(3) For wagon wholesalers, the difference in each case between the respective supplier's maximum price under the General Maximum Price Regulation and his maximum price under this regulation.

(b) For all sellers (other than wholesalers and retailers) not specifically mentioned in paragraph (a), the maximum price in each case shall be the supplier's maximum price, as established by this regulation for sales to that seller, adjusted where necessary to include incoming freight.

SEC. 4. *Pricing method for new container types and sizes.*—(a) *Processors (salters and briners and final processors).* The maximum price to any class of purchaser per unit of any listed commodity packed in a container type or size for which a processor (salter, briner, or final processor) cannot establish a maximum price under section 3 of this regulation shall be figured as follows. He shall:

(1) *Determine the base container.* If before November 2, 1943, the processor sold the same product (that is, the same kind, brand, grade, variety, count, and style of pack) but only in other container types or sizes, he shall first determine the most similar container type in which he is able to calculate a maximum price for that product under this regulation (even though he no longer sells that container type). From that container type he shall choose the nearest size which is 50% or less larger than the new size, or if there is no such size, 50% or less smaller (even though he no longer sells those sizes). This will be the "base container". If there is no such smaller size, he shall go to the next most similar container type and proceed in the same manner to find the base container.

NOTE: In most cases "the most similar container type" will be merely the container type which the processor is adding or replacing, like the tin which he may be replacing with glass. Where there has been only a size change, "the most similar container type" will, of course, be the same container type. This is also true in the reverse situation; where there has been a change only in container type, "the nearest size" will be the same size.

(2) *Find the base price.* The processor shall take as "the base price" his maximum price under this regulation for the product when packed in the base container. However, if this maximum price is a price delivered to the purchaser or to any point other than the processor's shipping point, the processor shall first convert it to a base price f. o. b. shipping point by deducting whatever transportation charges were included in it.

(3) *Deduct the container cost.* Taking his base price f. o. b. shipping point,

---

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 9388, 10569, 10987, 13293.
[2] 8 F.R. 9395, 10569, 10987, 12443, 12611, 13294.
[3] 8 F.R. 9407, 10570, 10988, 12443, 12611, 13294.
[4] 8 F.R. 4132, 5987, 7662, 9998.

the processor shall then subtract the direct cost of the base container. "Direct cost of the container" means the net cost, at the processor's plant, of the container, cap, label and proportionate part of the outgoing shipping carton but it does not include cost of filling, closing, labeling or packing.

(4) *Adjust for any difference in contents.* The figure obtained by this deduction shall then be adjusted, in the case of a size change, by dividing it by number of units (ounces, pounds, etc.) in the base container and multiplying the result by the number of the same units in the new container.

(5) *Add the new container cost to get the price f. o. b. shipping point.* Next, the processor shall add to the adjusted figure the "direct cost of the container" in the new type and size. If his maximum price for the commodity in the base container is an f. o. b. shipping point price, the resulting figure is the processor's maximum price, f. o. b. shipping point.

(6) *Convert to a maximum delivered price, if the maximum price for the base container is on a delivered basis.* If the processor's maximum price for the product in the base container is a delivered price, he shall figure transportation charges to be added, as follows: The processor shall take the transportation charges which he first deducted to get his base price and adjust them in exact proportion to the difference in shipping weight. If for any reason the product in the new container will move under a different freight tariff classification, the processor shall figure his transportation charges (by the same means of transportation and to the same destination) on the basis of the new shipping weight, but at the rate in effect for that freight tariff classification on March 17, 1942. Increases in tariff rates or transportation taxes made since March 17, 1942, shall not be taken into account. (Similar principles shall apply where shipping volume is the measure of the transportation charge.) The processor shall then add these transportation charges to his f. o. b. shipping point price for the commodity in the new container. The resulting figure is the processor's maximum delivered price.

(b) *Wagon wholesalers.* The maximum price to any class of purchasers per unit of any listed commodity for which a wagon wholesaler cannot establish a maximum price under section 3 of this regulation shall be figured as follows. He shall (1) select from the same general classification and price range as the item being priced the most closely comparable item for which a maximum price is established under any regulation; (2) divide his current selling price for that item by its actual cost, delivered to him; and (3) multiply the figure so obtained by the current cost, delivered to him, of the item being priced. The resulting figure is his maximum price.

SEC. 5. *Elective pricing method for final processors.* This optional method of determining a maximum price may be used by any final processor who cannot establish a maximum price for the particular item under sections 3 and 4 of this regulation. This pricing method does not apply to other sellers, nor does it apply to sales of salt stock.

The maximum price for a final processor electing to use this method shall be:

(a) His total "direct cost," per dozen or other unit of the food commodity being priced, figured by adding:

(1) The total cost per unit of all ingredients and packaging materials subject to maximum prices established by the Office of Price Administration, at the current maximum prices applying to the class of purchasers to which he belongs, plus

(2) The total cost per unit of every ingredient and packaging material for which no maximum price has been prescribed by the Office of Price Administration, figured at the current market price of the ingredient or packaging material in question, plus

(3) The direct labor cost per unit figured at the October 3, 1942, wage rates, plus

(4) Transportation charges by the usual mode of transportation if the cost factors used in (i) and (ii) above are not delivered costs, and if such charges are customarily incurred from his customary supply point to his customary receiving point,

(b) Multiplied by a markup percentage figured by making the following division:

(1) The maximum selling price (established under the General Maximum Price Regulation or other maximum price regulation in effect at the time of the calculation) reported under section 12 of this regulation for the most closely comparable commodity produced by him with cost factors similar to that of the item being priced, divided by:

(2) His current cost of ingredients, packaging materials and direct labor of that commodity.

As used in this paragraph, "most closely comparable commodity" means a food commodity which is most nearly similar and whose "direct cost" is closest to and in no event is less than two-thirds of the "direct cost" of the item being priced, and whose maximum price does not exceed 150% of its direct cost, and where similar methods are employed in its sale and merchandising to those which will be used in the sale and merchandising of the commodity being priced thereunder.

As used in this paragraph, "current" means current at the time of calculating the price reported under section 12 of this regulation.

(c) In deciding whether items of labor cost are to be applied as separate items in figuring the price or are to be treated as overhead, the seller shall follow his customary practice as of March 1942, for the product he is pricing and the most closely comparable product.

(d) The seller shall employ no cost factors in addition to those which he used with respect to the comparable commodity by which he determined his percentage mark-up under paragraph (a) and shall make no changes in the method of application of those factors which would result in a higher price.

Example. You are a processor who wishes to manufacture and sell sweet pickles in units of 12 pint jars, which you have not produced before. You compute your "direct costs" for the new item, as stated in (1) (2) (3) and (4) above. Assume the total cost is $1.26 per dozen. Next you select the most closely comparable item which you have produced and for which you have a maximum price, and determine the total of the "direct costs" for that item. Suppose this item is your sweet mixed pickles, for which the total direct costs are $1.14 per dozen, and for which your maximum price is $1.55 per dozen. You divide $1.55 by $1.14 (as stated in (b) (1) and (2)) and arrive at a mark-up figure of 136%. Your maximum price for sweet pickles is therefore your total direct costs ($1.26) multiplied by your percentage mark-up ($1.36), or $1.71 per dozen pints.

SEC. 6. *Applications for maximum prices.* The following provisions are applicable to salters and briners who cannot establish a maximum price under sections 3 and 4 of this regulation for the item being priced and to final processors who cannot establish a maximum price under those sections, or who elect not to price the item under section 5. Any such sellers shall file an application with the Office of Price Administration, Washington, D. C., for authorization of a maximum price, setting forth substantially the following:

(a) A description of the item for which a maximum price is sought, including its grade and the brand name to be used, if any, the number of packages in each shipping case, and a statement of the facts which make it different from the most similar item for which he has determined a maximum price, identifying the similar item and stating its maximum price.

(b) An itemized current cost breakdown of the items to be priced, showing separately according to his own system of accounts, or regularly prepared operating statements, all major component cost factors (e. g., direct costs, such as raw materials, packaging materials and direct labor; indirect costs, such as indirect labor, factory overhead, selling, advertising and administrative cost, together with an explanation showing the method of allocation of the indirect cost factors; and freight if sold on a delivered basis) indicating whether each cost item is an actual or an estimated cost, and the identical cost breakdown of the most closely comparable food commodity which contributes substantially to his total volume of business.

(c) The desired selling price for the item, including a statement showing the necessity for the desired selling price, any discounts or allowances which should be made applicable to the desired price, and (for comparison) the maximum selling price, with discounts and allowances,

for the second commodity included in paragraph (b) of this section.

(d) The method of distribution to be employed by the seller in marketing the new commodity (i. e. whether it is to be sold to wholesalers, retailers, consumers, or other classes of purchasers). Upon receipt of such application, the Office of Price Administration will authorize the maximum price for the applicant and, where appropriate, maximum prices for distributors of the item.

Until a maximum price is authorized, the applicant may deliver the item but he may not render an invoice nor receive payment for it.

Where any cost factor set forth in the application is an estimated amount, the packer shall file with the Office of Price Administration, Washington, D. C., within six months but earlier than three months after his maximum price has been authorized, a statement showing the actual cost of the factor in his production of the item prior to the filing date of such statement.

SEC. 7. *Notification of change in maximum prices.* With the first delivery after November 1, 1943, of any of the listed commodities in any case where a seller covered by this regulation has determined or shall determine his maximum price pursuant to sections 3 or 4 of this regulation, he shall:

(a) Supply each wholesaler and retailer who purchases from him with written notice as set forth below:

(Insert date)

Notice to Wholesalers and Retailers

Our OPA ceiling price for_____

(Describe item by kind, brand, grade, variety, count and container type and size)

has been changed by the Office of Price Administration. We are authorized to inform you that if you are a wholesaler or retailer pricing this item under MPRs 421, 422, or 423, you must refigure your ceiling price for this item on the first delivery of it to you from your customary type of supplier containing this notification on or after November 2, 1943. You must refigure your ceiling price following the rules in section 6 of MPR 421, 422, or 423, whichever is applicable to you.

For a period of 60 days after making such change in the maximum price of an item, and with the first shipment after the 60-day period to each person who has not made a purchase within that time, each such seller shall include in each case or carton containing the item the written notice set forth above, or securely attach it to the case or carton. For sales direct to any retailer the seller may insert the notice in the invoice accompanying the shipment instead of including it in or attaching it to each case or carton.

(b) Notify each purchaser of the item from him who is a distributor other than a wholesaler or retailer of such change in maximum price by written notice attached to or written on the invoice issued in connection with his first transaction with such purchaser after November 1, 1943, as follows:

(Insert date)

Notice to Distributors Other Than Wholesalers and Retailers

Our OPA ceiling price for

(Describe item by kind, brand, grade, count, variety and container type and size)

has been changed from $ to $ under the provisions of MPR No. 488. You are required to notify all wholesalers and retailers for whom you are the customary type of supplier, purchasing the item from you after November 1, 1943, of any allowable change in your maximum price. This notice must be made in the manner prescribed in section 9 (a) of MPR No. 488.

SEC. 8. *Adjustable pricing.* Any person may agree to sell at a price which can be increased up to the maximum price in effect at the time of delivery; but no person may, unless authorized by the Office of Price Administration, deliver or agree to deliver at prices to be adjusted upward in accordance with action to be taken by the OPA after delivery. Such authorization may be given when a request for a change in the applicable maximum price is pending, but only if the authorization is necessary to promote distribution or production and if it will not interfere with the purposes of the Emergency Price Control Act of 1942, as amended. The authorization may be given by the Administrator or by any official of the OPA having authority to act upon the pending request for a change in price, or to give the authorization. The authorization will be given by order.

SEC. 9. *Fractions of cents.* If any maximum price figured under this regulation includes a fraction of a cent, the seller shall adjust the price to the nearest fractional unit (like 1¢, ½¢, ¼¢, etc.) in which he has customarily quoted prices for the item.

SEC. 10. *Position of brokers.* In accordance with existing trade custom, every broker taking part in a sale covered by this regulation shall be deemed the agent of the seller and not of the buyer. In each case, the amount paid by the buyer to the broker plus the amount paid by the buyer to the seller shall not exceed the seller's maximum price, plus allowable transportation actually paid by the seller or by the broker.

SEC. 11. *Records which sellers must keep.* Every person subject to this regulation shall, so long as the Emergency Price Control Act of 1942, as amended, remains in effect, preserve for examination by the Office of Price Administration all his records, including invoices, sales tickets, cash receipts, or other written evidences of sale or delivery which relate to the prices charged pursuant to the provisions of this regulation, together with records of the same kind as he has customarily kept, relating to the prices which he charges for listed items after the effective date of this regulation, and in addition, as precisely as possible, the basis upon which he determined maximum prices for these commodities.

SEC. 12. *Reports which sellers must file.* (a) Every seller whose maximum prices are determined by section 3 of this regulation shall, on or before December 2, 1943, file with the nearest office of the Office of Price Administration a statement showing his maximum price for each selling unit to each class of purchasers, and the method of computing the price.

(b) Every seller who establishes a maximum price under the provisions of section 5 of this regulation shall within 10 days after determining such price file a report thereof with the nearest office of the Office of Price Administration.

Such report shall set forth, in addition to the price, (1) a description and identification of the food commodity for which such price was determined, and (2) a statement of facts which differentiate such food commodity from the most closely comparable commodity delivered or offered for delivery during March 1942 by such producer or by other competitive sellers of the same class, and (3) a statement that the maximum price reported was determined in accordance with section 5 of this regulation, and the facts in support of such statement. The supporting statement shall consist of a statement breaking down the price reported showing the calculations entering into the determination of "direct cost" and maximum selling price of both the product being priced and the most closely comparable commodity used, including statements showing customary suppliers of any ingredients or packaging materials for which no maximum price exists and the purchase price thereof. The maximum price reported by a producer in accordance with those provisions shall be subject to adjustment at any time by the Price Administrator.

SEC. 13. *Relation between this regulation and the General Maximum Price Regulation.* This regulation supersedes the provisions of the General Maximum Price Regulation with respect to the listed commodities and sellers covered by it. However, the following provisions of the General Maximum Price Regulation shall apply to the listed commodities and sellers covered by this regulation:

(1) Transfers of business or stock in trade (§ 1499.5).
(2) Federal and State taxes (§ 1499.7).
(3) Current records (§ 1499.12).
(4) Sales slips and receipts (§ 1499.14).
(5) Definitions (§ 1499.20).

SEC. 14. *Compliance with this regulation*—(a) *No selling or buying above maximum prices.* On and after November 2, 1943, regardless of any contract or other obligation, no person shall sell or deliver, and no person, in the course of trade or business, shall buy or receive any of the pickles or pickled products covered by this regulation at prices higher than the maximum prices established by this regulation, and no person shall agree, offer, solicit, or attempt to do any of the foregoing. Lower prices than the maximum prices may be charged and paid.

(b) *Evasion.* Nor shall any person evade a maximum price, directly or indirectly, whether by commission, service, transportation or other charge or discount, premium or other privileges; by tying-agreement, or other trade understanding; by any change of style or pack; by a business practice relative to grad-

ing, labelling or packaging; or in any other way.

(c) *Enforcement.* Any person violating a provision of this regulation is subject to the criminal penalties, civil enforcement actions, and suits for treble damages provided by the Emergency Price Control Act of 1942, as amended.

(d) *Licensing.* The provisions of Licensing Order No. 1,[5] licensing all persons who make sales under price control are applicable to all sellers subject to this regulation or schedule. A seller's license may be suspended for violations of the license or of one or more applicable price schedules or regulations. A person whose license is suspended may not, during the period of suspension, make any sale for which his license has been suspended.

SEC. 15. *Petitions for amendment.* Persons seeking a modification of this regulation may file a petition therefore in accordance with the provisions of Revised Procedural Regulation No. 1,[6] issued by the Office of Price Administration.

This regulation shall become effective November 2, 1943.

NOTE: All reporting and record-keeping requirements of this regulation have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17728; Filed, November 2, 1943; 5:05 p. m.]

PART 1347—PAPER, PAPER PRODUCTS, RAW MATERIALS FOR PAPER AND PAPER PRODUCTS, PRINTING AND PUBLISHING

[MPR 484,[7] Amdt. 1]

UNWASHED AND WASHED WIPING CLOTHS

A statement of the considerations involved in the issuance of this amendment has been issued simultaneously herewith and has been filed with the Division of the Federal Register.*

The effective date provision of Maximum Price Regulation No. 484 is amended to read as follows:

This Maximum Price Regulation No. 484 shall become effective October 18, 1943, or November 2, 1943, at the option of each individual seller, except that with respect to the operation of Appendix B (a) (6) the effective date shall be December 2, 1943.

This Amendment No. 1 to Maximum Price Regulation No. 484 shall become effective as of 12:01 a. m., November 2, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17723; Filed, November 2, 1943; 5:04 p. m.]

---

*Copies may be obtained from the Office of Price Administration.

[5] 8 F.R. 13244.

[6] 7 F.R. 8961; 8 F.R. 3313, 3353, 6173, 11806.

[7] 8 F.R. 14220.

PART 1407—RATIONING OF FOOD AND FOOD PRODUCTS

[RO 16,[1] Amdt. 22 to Supp. 1]

MEAT, FATS, FISH AND CHEESES

Section A of the Official Table of Trade Point Values (No. 8), referred to in paragraph (a) of § 1407.3027 and filed with the Division of the Federal Register,* is amended by adding the following items to the category of "Miscellaneous meats" under the title "Meat in tin or glass containers:"

Beef and gravy	9.8
Pork and gravy	7.5

This amendment shall become effective November 2, 1943.

(Pub. Law 671, 76th Cong., as amended by Pub. Laws 89, 421, 507 and 729, 77th Cong.; E.O. 9125, 7 F.R. 2719; E.O. 9280, 7 F.R. 10179; WPB Directive 1, 7 F.R. 562; and Supp. Dir. 1-M, 7 F.R. 8234; Food Directive 1, 8 F.R. 827; Food Dir. 3, 8 F.R. 2005; Food Dir. 5, 8 F.R. 2251; Food Dir. 6, 8 F.R. 3471; Food Dir. 7, 8 F.R. 3471)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17726; Filed, November 2, 1943; 5:04 p. m.]

PART 1407—RATIONING OF FOOD AND FOOD PRODUCTS

[RO 16,[1] Amdt. 23 to Supp. 1]

MEAT, FATS, FISH AND CHEESES

The Official Tables of Consumer and Trade Point Values (No. 8), referred to in paragraph (a) of § 1407.3207 and filed with the Division of the Federal Register,* are amended by changing the point value of hamburger on both the trade and consumer tables from 7 points per pound to 8 points per pound and by amending the sentence following the word "hamburger" on the consumer table and the sentence following the word "hamburger" in footnote 1 to section A of the trade table to read as follows:

Beef of all grades ground from necks, flanks, shanks, skirts, heel of round, briskets, plates, miscellaneous beef trimmings and beef fat. It also includes Grade D beef ground from skeletal portions of the dressed carcass (but not including head meat).

This amendment shall become effective November 2, 1943.

(Pub. Law 671, 76th Cong., as amended by Pub. Laws 89, 421, 507 and 729, 77th Cong.; E.O. 9125, 7 F.R. 2719; E.O. 9280, 7 F.R. 10179; WPB Directive 1, 7 F.R. 562; and Supp. Dir. 1-M, 7 F.R. 8234; Food Directive 1, 8 F.R. 827; Food Dir. 3, 8 F.R. 2005; Food Dir. 5, 8 F.R. 2251; Food Dir. 6, 8 F.R. 3471; Food Dir. 7, 8 F.R. 3471)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17727; Filed, November 2, 1943; 5:04 p. m.]

---

[1] 8 F.R. 3591, 3714, 4892, 5408, 5758, 6840, 7264, 7492, 8869, 9203, 10090, 10728, 11688, 12299, 12444, 12549.

PART 1429—POULTRY AND EGGS

[Rev. MPR 269,[1] Amdt. 20]

POULTRY

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

The effective date provision of Amendment 16 to Revised Maximum Price Regulation 269 is amended to read as follows:

Amendment 17 shall become effective October 11, 1943, except that § 1429.19 (h) (2) shall become effective January 1, 1944.

This amendment shall become effective as of October 11, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17729; Filed, November 2, 1943; 5:06 p. m.]

PART 1312—LUMBER AND LUMBER PRODUCTS

[MPR 348,[2] Amdt. 12]

LOGS AND BOLTS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation 348 is amended in the following respects:

1. Appendix G, Table 5 is amended by the addition of the following unnumbered paragraph.

Dealer's Commission. When the consumer purchases chemical wood from a dealer, a dealer's allowance not to exceed 50 cents per cord (as defined in this table) may be paid in addition to the above maximum prices. A dealer is a person engaged in buying and selling chemical wood not produced by himself. The allowance must be separately shown on the billing or settlement sheet and must not be charged on any of the wood which has been produced by the dealer himself.

This amendment shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17745; Filed, November 3, 1943; 11:43 a. m.]

---

[1] 7 F.R. 10708, 10864, 11118; 8 F.R. 567, 856, 878, 2289, 3316, 3419, 3792, 6736, 9299, 10940, 11691, 13302, 13813, 14016.

[2] 8 F.R. 3670, 5163, 5565, 6356, 8751, 9515, 10023, 11214, 12797, 13337, 14212.

PART 1340—FUEL

[RPS 88, Correction to Amdt. 131 [1]]

PETROLEUM AND PETROLEUM PRODUCTS

The following is inserted between § 1340.159 (b) (11) (iv) (*a*) (*1*) (*ii*) and (iv) (*a*) (2):

(*iii*) 60,000 gallons or more one quarter cent (¼¢) per gallon less than the maximum price established under (*i*).

This correction shall become effective November 2, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17747; Filed, November 3, 1943; 11:43 a. m.]

PART 1364—FRESH, CURED AND CANNED MEAT AND FISH

[Rev. MPR 148,[1] Amdt. 12]

DRESSED HOGS AND WHOLESALE PORK CUTS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Revised Maximum Price Regulation No. 148 is amended in the following respects:

1. Section 1364.32 (c) (23) is amended to read as follows:

(23) "Boneless pork loins or Canadian bacon" means the boneless eye-muscle only, which has been separated from the other parts of the pork loin at the natural muscle seam. The fat shall not exceed ¼ inch in thickness.

2. Item 16 of Schedule I (a) of § 1364.35 is amended to read as follows:

Item	Green or frozen		Cured		Smoked (wrapped)		Ready-to-eat (wrapped)		Cooked	
	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)
* * *	*	*	*	*	*	*	*	*	*	*
16. Loins-boneless (may not be sold to retailers)		33.50		34.00						

3. Items 17, 18 and 19 of Schedule I (a) of § 1364.35 are redesignated items 18, 19, and 20 respectively.

4. Item 17 of Schedule I (a) of § 1364.35 is added to read as follows:

* Item	Green or frozen		Cured		Smoked (wrapped)		Ready-to-eat (wrapped)		Cooked	
	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)	Weight (pounds)	Price (dollars)
* * *	*	*	*	*	*	*	*	*	*	*
17. Canadian bacon						41.25		45.00		

This amendment shall become effective November 9, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17753; Filed, November 3, 1943; 11:46 a. m.]

PART 1340—FUEL

[RPS 88,[2] Amdt. 133 [1]]

PETROLEUM AND PETROLEUM PRODUCTS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 1340.156 (d) is added to read as set forth below:

(d) *Local shortages.* The Office of Price Administration, or any duly authorized representative thereof, may adjust by order any maximum price established under this schedule for any seller or group of sellers when it appears:

(1) That there exists or threatens to exist in a particular locality a shortage in the supply of a petroleum product which aids directly in the war program or is essential to a standard of living consistent with the prosecution of the war; and

(2) That such local shortage will be substantially reduced or eliminated by adjusting the maximum prices of such seller and of like sellers for such petroleum product; and

(3) That such adjustment will not create or tend to create a shortage, or a need for increase in prices, in another locality, and will effectuate the purposes of the Emergency Price Control Act of 1942, as amended.

NOTE: Applications for adjustment shall be filed in Washington, D. C., in accordance with Revised Procedural Regulation No. 1.

This amendment shall become effective November 8, 1943.

NOTE: The reporting and record-keeping requirements of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17746; Filed, November 3, 1943; 11:44 a. m.]

PART 1364—FRESH, CURED AND CANNED MEAT AND FISH PRODUCTS

[MPR 364,[1] Amdt. 7]

FROZEN FISH AND SEAFOOD

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation 364 is amended in the following respects:

1. In section 12, after the definition of "cellophane wrapped" and before the definition of "Cry-o-vac wrapped" the following definition is inserted:

"Count", as applied to shrimp and prawn, means the number of processed shrimp or prawn to the pound.

2. In section 12, after the definition of "Gutted" and before the definition of "Individually frozen" the following definition is inserted:

"Headless" means shrimp and/or prawn from which the head has been removed.

3. In section 12, after the definition of "Headless" and before the definition of "Individually frozen" the following definition is inserted:

"Headless and veined" means shrimp and/or prawn from which the head and alimentary canal (sand vein) have been removed.

---

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 14150.

[2] 7 F.R. 8609, 9005, 8948; 8 F.R. 544, 2922, 3367, 4785, 7322, 7671, 7828, 8376, 8677, 10571, 10732, 11380, 9998, 13296.

[3] 8 F.R. 3718.

[1] 8 F.R. 4640, 5566, 7592, 11175, 12023, 12446, 12792, 14079.

4. In section 12, after the definition of "Headless and veined" and before the definition of "Individually frozen" the following definition is inserted:

"Head-on" means shrimp and/or prawn as it comes from the water.

5. In section 12, after the definition of "Parchment wrapped" and before the definition of "Peeled and veined" the following definition is inserted:

"Peeled" means shrimp and/or prawn from which the head and shell have been removed.

6. In section 14, Schedule No. 54 is amended to read as follows:

FROZEN FISH AND SEAFOOD

Sched. No.	Name	Item No.	Style of processing	Size	Base price per pound
54	Shrimp and prawn [1]	1	Head-on	Under 9 Count	$.20
		2	Head-on	9 to 12 Count	.18
		3	Head-on	12 to 15 Count	.16
		4	Head-on	15 to 18 Count	.14
		5	Head-on	18 to 25 Count	.12½
		6	Head-on	26 to 39 Count	.11
		7	Head-on	40 and over Count	.09½
		8	Headless	Under 15 Count	.36
		9	Headless	15 to 20 Count	.31½
		10	Headless	21 to 25 Count	.28
		11	Headless	26 to 30 Count	.24½
		12	Headless	31 to 42 Count	.22
		13	Headless	43 to 65 Count	.20
		14	Headless	66 and over Count	.17½
		15	Peeled	Under 18 Count	.44½
		16	Peeled	18 to 25 Count	.39½
		17	Peeled	26 to 31 Count	.35
		18	Peeled	32 to 37 Count	.31
		19	Peeled	38 to 51 Count	.28
		20	Peeled	52 to 80 Count	.25
		21	Peeled	81 and over Count	.22
		22	Peeled and veined	Under 20 Count	.51½
		23	Peeled and veined	20 to 27 Count	.45
		24	Peeled and veined	28 to 33 Count	.40½
		25	Peeled and veined	34 to 40 Count	.36
		26	Peeled and veined	41 to 56 Count	.33
		27	Peeled and veined	57 to 86 Count	.29½
		28	Peeled and veined	87 and over Count	.26½
		29	Headless and veined	Under 16 Count	.39½
		30	Headless and veined	16 to 21 Count	.35
		31	Headless and veined	22 to 27 Count	.31
		32	Headless and veined	28 to 32 Count	.27½
		33	Headless and veined	33 to 45 Count	.25
		34	Headless and veined	46 to 69 Count	.22½
		35	Headless and veined	70 and over Count	.20

This amendment shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17754; Filed, November 3, 1943; 11:47 a. m.]

PART 1364—FRESH, CURED AND CANNED MEAT AND FISH PRODUCTS

[MPR 389,[1] Amdt. 9]

CEILING PRICES FOR CERTAIN SAUSAGE ITEMS AT WHOLESALE

A statement of the considerations involved in the issuance of this amendment has been issued simultaneously herewith and filed with the Division of the Federal Register.*

Maximum Price Regulation No. 389 is amended in the following respects:

1. Section 4 (b) (2) is amended to read as follows:

(2) *Where the label must be placed.* A label satisfying the requirements of this paragraph shall appear on each one and one-half pounds of frankfurters and pork or breakfast sausage other than bulk, and once on each piece of bologna or other sausage of similar form, or pork or breakfast sausage stuffed in artificial casings. The label may be a band or tag securely affixed to the sausage or printed or stamped upon the casing. A similar label shall also be stamped upon the wrapper, carton or other immediate container in which the sausage is placed.

2. Section 4 (b) (3) (iii) is amended to read as follows:

(iii) Whatever of the following letters or words are appropriate to show the kind of casing used: H. C. for hog casing; S. C. for sheep casing; A. C. for artificial casing, except that no such designation is required for an artificial casing on which is printed the casing manufacturer's name or trademark; skinless, where artificial casings have been removed by the manufacturer. Where the same price applies to the sausage in more than one kind of natural casings, the letters N. C., indicating natural casing, may be used.

3. Section 4 (b) (5) is amended to read as follows:

(5) *Description on invoice.* The name and type of sausage and the kind of casing, cup, carton or wrapper in which the sausage is sold, must be shown on the seller's invoice, except that the kind of casing, cup, carton or wrapper need not be shown where the same price applies to the sausage no matter what kind of casing, cup, carton or wrapper is used. Also the kind and size of container must be shown on the invoice if the price of the sausage includes an addition for the container pursuant to section 12 (c) (3). Kosher sausage and all beef sausage shall be designated as such on the invoice in addition to other information required by this paragraph.

4. Item (1) (i) of the price table in section 12 (a) is amended to read as follows:

Item—Kind of sausage and kind of casing, cup, carton or wrapper	Type 1—Special pork	Type 2—Skeletal meat	Type 3—Meat; by-products; cereal to 3½%	Type 4—Meat; by-products; cereal over 3½%
* *	*	*	*	*
(i) Fresh:				
Sheep casings (S. C.)	$33.25	$31.00	$25.50	$20.50
Hog casings (H. C.)	-------	28.00	22.50	17.50
Artificial casings (A. C.) or sealed heavy cardboard waxed cups, 1 lb. each or less	-------	26.50	21.00	16.00
Cardboard cartons or sealed packages of moisture resistant paper, 1 lb. each or less	-------	25.50	20.00	13.00
Bulk	26.75	24.50	19.00	12.00

5. A definition of "artificial casing", inserted in the proper alphabetical place in section 13 (b), is added to read as follows:

"Artificial casing" means only a cellulose or fibrous casing, or a heavy cloth bag.

6. The definition of "yield" in section 13 (b) is amended to read as follows:

"Yield" means the finished weight divided by the original weight of the meat, meat by-products and extender used and expressed as a percentage.

7. The definition of "frankfurters" in section 13 (c) is amended to read as follows:

"Frankfurters" means a sausage stuffed in sheep casings, hog casings, or in artificial casings of a similar size, which has been smoked and cooked. It includes all products commonly known as wieners, red hots, and other similar names. If artificial casings are used they must be either removed before sale or have printed on them the words, "Before Heating or Eating Remove Artificial Casings," repeated so as to appear at least once on each link or piece.

8. The definitions of "pork or breakfast sausage", "Type 2 fresh pork sausage" and "Type 3 fresh breakfast sausage" in section 13 (d) are amended to read as follows:

"Pork or breakfast sausage" means sausage sold in bulk, or stuffed in sheep, hog or artificial casings, or packed in a sealed, printed heavy cardboard waxed cup, sealed printed cardboard carton, or sealed printed wrapper made from cellophane, parchment or other moisture resistant paper, with such cup, carton or wrapper having the sausage manufacturer's brand name or trade-mark print-

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 5903, 6958, 6945, 8185, 8677, 10906, 10907, 11956, 13340.

ed thereon. Such sausage includes all sausage of the kinds commonly known as pure pork sausage, breakfast sausage or country sausage. If artificial casings other than cloth bags are used on smoked pork or smoked breakfast sausage, they must either be removed before sale or have printed on them the words, "Before Heating or Eating, Remove Artificial Casing", repeated so as to appear at least once on each link or piece. Fresh pork or breakfast sausage shall be considered bulk sausage if it is enclosed in an unprinted cup, carton or wrapper, or if more than one pound of such sausage is enclosed in an artificial casing, printed cup, carton or wrapper.

"Type 2 fresh pork sausage" means sausage made from pork which has a fat content not in excess of 50 percent, which contains no extender and which has yield not in excess of 100 percent.

"Type 3 fresh breakfast sausage" means a sausage which is made from skeletal meat of swine as a major ingredient and no more than two other meats and meat by-products as minor ingredients, except that detached beef fat may not be used, which has a fat content not in excess of 30 percent, which has a yield not in excess of 100 percent and which may contain no more than 3½ percent of extender. The quantity of each minor ingredient shall be less than the quantity of the major ingredient.

This amendment shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17755; Filed, November 3, 1943; 11:48 a. m.]

PART 1373—PERSONAL AND HOUSEHOLD ACCESSORIES

[MPR 476,[1] Amdt. 1]

LUGGAGE

A statement of considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation No. 476 is amended in the following respects:

1. Section 9 is amended by adding paragraph (c) to read as follows:

(c) Any regional office of the Office of Price Administration or such other offices as may be authorized by the appropriate regional offices, may by order fix retail ceiling prices for luggage pursuant to paragraph (b) of this section.

2. Section 11 is amended by adding a new paragraph (c) to read as follows:

(c) Any regional office of the Office of Price Administration or such other offices as may be authorized by the appropriate regional offices, may by order fix retail ceiling prices for luggage pursuant to paragraph (b) of this section.

This amendment shall become effective on the 8th day of November 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17748; Filed, November 3, 1943; 11:45 a. m.]

PART 1375—EXPORT PRICES

[2d Rev. Max. Export Price Reg.,[1] Amdt. 4]

LARD

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

The 2d Revised Maximum Export Price Regulation is amended by adding a new section 7 (e) to read as follows:

(e) *Lard.* The maximum export premium to be charged on an export sale of lard shall be 8 percent of the maximum price for the particular type of lard, appropriately packed, at the Chicago basing point, determined under Maximum Price Regulation No. 53.

This Amendment No. 4 shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17749; Filed, November 3, 1943; 11:45 a. m.]

PART 1382—HARDWOOD LUMBER

[MPR 223,[2] Amdt. 9]

NORTHERN HARDWOOD LUMBER

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation No. 223 is amended in the following respect:

In § 1382.166 (c), subparagraph (2) is amended to read as follows:

(2) When a truck haul precedes the rail shipment, as when a mill located away from a railhead hauls lumber by truck to the railhead, no addition may be made for such truck haul. However, a mill may apply for special permission to make an addition, when its rail connection has been abandoned since September 5, 1941. The application should be made by letter to the Lumber Branch of the Office of Price Administration, Washington, D. C. The addtion may not be made in quotations or sales until permission has been received.

This amendment shall become effective November 8, 1943.

NOTE: All reporting and record-keeping requirements of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17750; Filed, November 3, 1943; 11:44 a. m.]

PART 1383—SHOES AND SHOE FINDINGS

[MPR 420,[1] Amdt. 2]

HARDWOOD HEEL BLOCKS, FINISHED HARDWOOD HEELS AND WOOD SHANKS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation 420 is amended in the following respects:

1. The words "hardwood heel blocks and finished hardwood heels", wherever they appear, excepting in sections 3 and 4, are amended to read as follows: "Hardwood heel blocks, finished hardwood heels and wood shanks."

2. Section 2 (a) is amended by adding thereto the following paragraph:

"Wood shank" means an oblong or rectangular shaped wood product used to support the shank portion of a shoe.

3. Section 4a is added to read as follows:

SEC. 4a. *Maximum prices for wood shanks*—(a) *Maximum prices for producers.* The maximum price for any wood shank sold by the following producers and listed on the seller's price list or lists, published or confidential, in effect on March 31, 1942, shall be the net price which the seller would have received on that date from a purchaser of the same class increased by the percentage specified:

(1) United Shank and Findings Company, Plymouth, New Hampshire, 10%;

(2) U. S. Pegwood and Shank Company, Brownsville, Maine, 25%;

(3) General Manufacturing Company, Bingham, Maine, 35%.

(b) *Maximum prices for other sellers.* (1) The maximum price to any purchaser for any wood shank sold by a seller other than the producer and listed on the seller's price list or lists, published or confidential, in effect on March 31, 1942, shall be the net price which the seller would have received on that date

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 13977.

[1] 8 F.R. 4132, 5987, 7662, 9998.

[2] 7 F.R. 7445, 8945; 8 F.R. 121, 2783, 5480, 5629, 8945, 10939, 14136.

[1] 8 F.R. 9567, 9331.

from a purchaser of the same class, increased by the actual dollar-and-cents increase in cost to the seller resulting from paragraph (a) of this section.

(2) If a seller other than the producer had no published or confidential list price in effect on March 31, 1942, the maximum price to any purchaser shall be the net price determined by applying to the seller's net invoice cost of the wood shank, not to exceed the applicable maximum price, the average percentage mark-up, weighted by volume of sales over net invoice cost realized during March 1942 for all wood shanks sold by the seller during March 1942 to purchasers of the same class.

(c) "Net price" means the amount paid by or charged to the purchaser, after adjustment for all applicable extra charges, discounts or other allowances in effect on March 31, 1942.

This amendment shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17756; Filed, November 3, 1943; 11:46 a. m.]

PART 1384—HARDWOOD LUMBER PRODUCTS

[MPR 196,[1] Amdt. 5]

TURNED OR SHAPED WOOD PRODUCTS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation No. 196 is amended in the following respect:

Section 1384.52 (d) is added to read as follows:

(d) *Any sale of wood shanks.* For the purpose of this paragraph, a wood shank means an oblong or rectangular shaped wood product used to support the shank portion of a shoe.

This amendment shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17751; Filed, November 3, 1943; 11:44 a. m.]

*Copies may be obtained from the Office of Price Administration.

[1] 7 F.R. 6078, 7254, 8016, 8945, 11812.

PART 1404—RATIONING OF FOOTWEAR

[RO 17,[1] Amdt. 42]

SHOES

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Ration Order 17 is amended in the following respects:

1. Section 2.11 (a) (4) (ii) is amended by deleting the words "Rubber Reserve Corporation" and substituting "Rubber Reserve Company for reclaiming".

2. Section 2.11 (a) (6) is added, which reads as follows:

(6) Shoes of size 3 and below in the youths', boys', misses', and children's ranges, and of all sizes in the infants' range, which contain no leather, and no rubber except scrap rubber previously combined with fabric and vulcanized for other purposes, which is released by the Office of Rubber Director for use in the manufacture of shoes.

3. Section 2.11 (a) (7) is added, which reads as follows:

(7) Shoes which contain no leather and which have a sole made and fastened to the upper by a vulcanized construction, such as tennis shoes, gym shoes, and sneakers.

4. Section 2.15 (a) is amended by deleting the first sentence and substituting instead the following:

Any registered distributing establishment whose ration currency has been destroyed, damaged, lost or stolen, or whose shoes have been (1) taken from him by judicial process, or the enforcement of a security interest, (2) exported to a foreign country or to a territory or possession of the United States (other than the District of Columbia) or delivered as slop-chest supplies, ships' stores, or to Ships' Service Stores Afloat, pursuant to section 3.5, or transferred to or for the account of an exempt person or agency designated in section 3.6, without getting ration currency, (3) damaged, destroyed, lost or stolen, or (4) released from rationing under section 2.11 (a) (7), may get a certificate to replace the ration currency or shoes, as the case may be.

This amendment shall become effective November 8, 1943.

(Pub. Law 671, 76th Cong. as amended by Pub. Law 89, 421 and 507, 77th Cong.; W.P.B. Dir. 1, 7 F.R. 562, Supp. Dir. 1-T, 8 F.R. 1727; E.O. 9125, 7 F.R. 2719)

Issued this 2d of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17752; Filed, November 3, 1943; 11:46 a. m.]

[1] 8 F.R. 1749, 2040, 2487, 2943, 3315, 3371, 3851, 4129, 3948, 4716, 5589, 5678, 5679, 5867, 5756, 6046, 6687, 7198, 7261, 8060, 8064, 8357, 8601, 9062, 9422, 9567, 9884, 10269, 11445, 11515, 12026, 12137, 12180, 12547, 12548, 12515, 13128.

PART 1404—RATIONING OF FOOTWEAR

[RO 17,[1] Amdt. 43]

SHOES

A rationale accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Ration Order 17 is amended in the following respects:

1. Section 2.11 (a) is amended by deleting the phrase "Any person may mark and transfer as "nonrationed," shoes of the following types:" and substituting instead the following: "Shoes of the following types are nonrationed".

2. Section 2.11 (b) is deleted and a new paragraph (b) is added to read as follows:

(b) No one may demand or receive ration currency for nonrationed shoes or accept their return in exchange for a pair of rationed shoes or a stamp pursuant to section 1.10. However, ration currency must be collected for obsolete or single shoes sold above the price limitations specified in paragraph (g) of this section.

3. Section 2.11a is redesignated as section 2.11 (g) and is amended to read as follows:

(g). Any establishment or person having single shoes that cannot be mated, or obsolete shoes which cannot reasonably be sold for ration currency, may be authorized by the District Office to transfer them as nonrationed, in accordance with the following provisions:

(1) For the purpose of this section, "obsolete shoes" include only shoes which (i) have deteriorated substantially in quality, or have become discolored, as a result of age or exposure; or (ii) are of an outmoded last or design.

(2) Application to transfer the shoes as non-rationed shall be made to the District Office for the area where the establishment is located or, in the case of a person other than an establishment, to the District Office where the shoes are located. Only one application may be made unless the District Office, in its discretion, otherwise permits. The application need not be made on any prescribed

[1] 8 F.R. 1749, 2040, 2487, 2943, 3315, 3371, 3853, 4122, 3948, 4716, 5589, 5678, 5679, 5567, 6046, 6687, 7198, 7261, 8061, 9062, 9422, 9567, 9884, 10269 ,11445, 11515, 12026, 12137, 12180, 12547, 12548, 12515, 13301, 13128.

form but shall contain, or be accompanied by, the following:

(i) Two copies of a list of the shoes proposed to be transferred as non-rationed, with detailed information concerning the style, sizes, color, materials, age, and condition, and any additional pertinent facts which the District Office may require;

(ii) If the applicant is an establishment, a copy of its inventory form (OPA Form R–1701) filed as of April 10, 1943;

(iii) With respect to single shoes, a statement that they cannot be mated.

(3) The District Office, if it approves the application in whole or in part shall indicate its approval in writing and shall attach thereto a copy of the list of shoes submitted by the applicant, on which it shall indicate the specific shoes authorized to be transferred as non-rationed. The District Office shall issue to the applicant official Non-Rationed Stickers (OPA Form R–1711) equal to the number of pairs, plus the number of single shoes, permitted to be transferred as non-rationed. If Form R–1711 is not available, OPA Form R–123 may be used, with the words "Non-Rationed Shoes" printed on it. The District Office (or the applicant if required by the District Office) shall write or print on each such sticker the word "Obsolete" or, in the case of single shoes, the word "mismate" and a code number assigned by the District Office. However, if the shoes are to be transferred for salvage purposes to a specified person engaged in the business of repairing or making shoes, or to a shoe findings distributor or a dealer in scrap material, the District Office may authorize the transfer of the shoes as non-rationed without requiring them to be marked.

(4) Before any of such shoes may be transferred or offered for sale as non-rationed, except for salvage purposes pursuant to written authorization of the District Office, the applicant shall attach to one shoe of each pair and, in the case of single shoes that cannot be mated, to each single shoe, an official non-rationed sticker supplied by the District Office. Such sticker may be affixed only to shoes specifically permitted by the District Office to be transferred as non-rationed.

(5) These shoes are non-rationed only if sold at a price not in excess of $1.00 a pair (or 50 cents for a single shoe). If the shoes are sold by any establishment or person at a price in excess of $1.00 a pair (or 50 cents for a single shoe) he must collect ration currency and turn in the currency to the District Office within 5 days after the transfer.

(6) Shoes acquired by a person for salvage purposes, pursuant to a specific authorization of a District Office, may not be transferred thereafter as complete shoes, but the parts of the shoes may be used for the repair of or manufacture of other shoes or may be transferred to other persons for such purpose.

4. Section 2.13 (b) (4) is amended by adding after the words "2.11 (f)" the words "or 2.11 (g)".

This amendment shall become effective November 8, 1943.

NOTE: The record-keeping requirements and reporting provisions of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(Pub. Law 671, 76th Cong. as amended by Pub. Laws 89, 421 and 507, 77th Cong; WPB Dir. 1, 7 F.R. 562, Supp. Dir. 1–T, 8 F.R. 1727; E.O. 9125, 7 F.R. 2719)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43–17757; Filed, November 3, 1943; 11:46 a. m.]

PART 1407—RATIONING OF FOOD AND FOOD PRODUCTS

[RO 16[1], Amdt. 20 to Supp. 1]

MEAT, FATS, FISH AND CHEESES

Section 1407.3027 (f) is amended by adding the following validity dates for brown stamps:

L ---- November 21, 1943 to January 1, 1944.
M ---- November 28, 1943 to January 1, 1944.
N ---- December 5, 1943 to January 1, 1944.
P ---- December 12, 1943 to January 1, 1944.

This amendment shall become effective November 6, 1943.

(Pub. Law 671, 76th Cong., as amended by Pub. Laws 89, 421, 507 and 729, 77th Cong.; E.O. 9125, 7 F.R. 2719; E.O. 9280, 7 F.R. 10179; MPB Directive 1, 7 F.R. 562; and Supp. Dir. 1–M, 7 F.R. 8234; Food Directive 1, 8 F.R. 827; Food Dir. 3, 8 F.R. 2005; Food Dir. 5, 8 F.R. 2251; Food Dir. 6, 8 F.R. 3471; Food Dir. 7, 8 F.R. 3471)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43–17740; Filed, November 3, 1943; 11:44 a. m.]

PART 1418—TERRITORIES AND POSSESSIONS

[Rev. MPR 183,[2] Amdt. 11]

TEXTILES IN PUERTO RICO

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 54 is added to read as follows:

SEC. 54. *Maximum prices for imported textile products sold or delivered in the territory of Puerto Rico*—(a) *Definitions.* When used in this section the term:

(1) "Textile product" means a manufactured material or article consisting in chief part of wool or other animal fibre, cotton, rayon, silk, linen or synthetic textile fibre by whatever process manufactured, which falls within either Group A or Group B as listed below:

Group A:

Piece goods, yard goods or pound goods, and all garments with the exception of headwear and footwear and garments enumerated in Group B.

Group B:

Aprons	Infant's binders
Arm bands	Lace
Awnings	Lace edging
Bandanas	Laundry bags
Bath mats	Luncheon sets
Bedspreads	Mantillas
Belts	Mattress covers
Bias tape	Mattress pads
Bibs	Mittens
Blankets	Mops
Canvas	Mosquito nets
Chair slip covers	Napkins
Cleaning rags	Neckties
Clothes lines	Oilcloth
Collars	Pillow cases
Comforts	Polishing cloths
Couch slip covers	Quilts
Counterpanes	Ribbon, dress
Cuffs	Rick rack
Curtains	Scarfs
Diapers	Seat covers
Dinner sets	Sewing thread
Dish cloths	Sheets
Doilies	Shawls
Drapes	Shoe bags
Dress arm shields	Shower curtains
Dresses (women's and misses)	Suspenders
	Table cloths
Duffel bags	Table pads
Dust shields for garments	Tape, other than gummed or adhesive
Dusting cloths	Tape measures
Elastic	Ticking
Embroidery	Toilet seat covers
Fishing line	Towels
Garment bindings	Umbrellas
Garters	Veils
Gloves	Wash cloths
Handkerchiefs	Wrapping twine-string
Hosiery	Yarn
Hot dish holders	
Hot pot holders	

(2) "Job lot" means a single purchase of a group of units of textile products all of which in trade terms are "remnants", "shorts", "seconds", "pound goods", "imperfects", "close outs", or "substandards".

(3) "Broken job lot" means a job lot from which one or more of the textile products of which the lot is comprised was sold or delivered on November 22, 1943.

(4) "Unbroken job lot" means a job lot from which none of the textile products of which the lot is comprised was sold or delivered on November 22, 1943.

(5) "Textile reference book" means a book containing the seller's descriptive entries of the stock which he has on hand and which he is offering for sale.

(6) "Reference stock number" means the numbers employed by the manufacturer or supplier and the seller to identify a textile product.

(7) "Class of textile products" means a group of units of a textile product all of which are identically priced and which are received in one delivery.

---

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 3591, 3734, 4892, 5758, 6840, 7264, 7456, 7492, 7825, 8869, 9203, 10090, 10728, 11688, 12299, 12444, 12549, 13164, 13165, 13395.

[2] 8 F.R. 9532, 10763, 10906, 11437, 11847, 12549, 10937, 12632, 13165, 13847, 14090.

(b) *Maximum prices for imported textile products.* Sellers' maximum prices for imported textile products sold or delivered in the Territory of Puerto Rico shall be:

(1) The maximum price at wholesale and at retail for an imported textile product which has been imported by the seller shall be computed by multiplying the direct cost to the importer, as defined in section 17 (a) (4), by the applicable multiplier set forth in Table 45 below.

(2) The maximum price at retail for an imported textile product which has not been imported by the seller received by the retailer after the effective date of this section shall be computed by multiplying the price paid to the importer, which in no event may exceed the maximum price established by this or any other applicable regulation or order, by the applicable multiplier set forth in Table 45 below.

(3) The maximum price at retail for an imported textile product which has not been imported by the seller and which is in the inventory of the retailer on the effective date of this section shall be computed as follows:

(i) For all items except those which constitute broken job lots the retailer shall multiply the price paid by the applicable multiplier set forth in Table 45.

(ii) For items which constitute broken job lots the maximum price shall continue to be established by the General Maximum Price Regulation.[2]

TABLE 45—IMPORTED TEXTILE PRODUCTS

	Multipliers			
	At wholesale		At retail	
	Group A	Group B	Group A	Group B
Not purchased as part of job lot:				
Imported by seller	1.20	1.25	1.50	1.60
Not imported by seller	None	None	1.25	1.28
Purchased and sold as unbroken job lot:				
Imported by seller	1.20	1.25	1.50	1.60
Not imported by seller	None	None	1.25	1.28

(4) The purchaser of an unbroken job lot must compute the maximum price for the entire lot before selling or offering for sale the entire lot or any items contained therein. If the seller does not sell the unbroken lot as he received it, the total of the prices charged for parts of the lot may not exceed the maximum price for the entire unbroken job lot.

(5) If a job lot consists in part of items in Group A and in part of items in Group B, the maximum price for the unbroken job lot is to be computed by using the multiplier for Group B items.

(c) *Trade practices.* The markups authorized herein are gross markups which shall not be exceeded regardless of the number of sellers handling an imported textile product. No seller shall change his customary allowances, discounts or other price differentials or his customary alteration charges unless such change results in a lower net price.

(d) *Prohibited practices.* It shall be unlawful for any seller to improperly classify a textile product for the purpose of evading the appropriate pricing provision herein. It shall be unlawful for any seller to revise any maximum price fixed on an imported textile product and entered in his textile reference book except as otherwise provided in paragraph (g) (2).

(e) *Notification to OPA on sales of unbroken job lots.* Within five days of his first sale of a textile product from an unbroken job lot the seller shall file a statement with the Territorial Office of Price Administration, San Juan, Puerto Rico, and a duplicate thereof with his local War Price and Rationing Board, which statement shall show (1) the name and address of the person from whom the job lot was purchased, (2) a description of the job lot, (3) the number of units included in each class of textile products, (4) the direct cost of the job lot to the seller if it was imported by the seller, or the price paid for the job lot if it was not imported by the seller, (5) the reference stock numbers assigned as provided in paragraph (f) (6) the selling price of each unit or group of units as determined in accordance with the pricing provisions of paragraph (b) of this section, and the over-all markup taken by the seller on the job lot.

(f) *Identification of imported textile products.* Every seller shall assign a separate reference stock number to each price classification of imported textile products and shall clearly identify the physical merchandise with the reference stock number by use of a label, tag, slip, sticker, mark, or other similar appropriate marking.

(g) *Textile reference book.* (1) Every person selling imported textile products shall prepare a textile reference book which he shall keep and make available for examination by the Office of Price Administration, in which shall be entered prior to the time any imported textile product is sold or offered for sale, the following information for each price classification of imported textile products in the seller's stock: (1) The reference stock number, (2) a description of the units comprised, (3) the name and address of the supplier, except in the case of merchandise from a broken job lot, (4) the date of delivery, except in the case of merchandise in a broken job lot, (5) the multiplier used in computing the maximum price, (6) the direct cost to the seller or the price paid by the seller, whichever price is material in accordance with the pricing provision utilized, and (7) the seller's selling price at wholesale or at retail depending upon the level at which he sells.

(2) The maximum price charged by each seller and entered in his textile reference book shall in no instance be altered except that should the seller have erroneously computed the price for an item entered in such book, the seller's Local War Price and Rationing Board may, after having received a written statement of the facts from the seller, if satisfied that the entry was the result of a miscalculation, authorize such seller to change the entry to correspond with the maximum price which he is authorized to charge in accordance with this regulation.

(3) All entries in the textile reference book shall be made in numerical sequence. All imported textile products in inventory on November 22, 1943 shall be recorded before entries are made of any items subsequently received. Before the first entry on such inventory the seller shall state: "Inventory as of _____, 1943." Prior to recording each subsequent delivery of any items in the textile reference book, the seller shall note "New merchandise received on _____, 1943." Imported textile products received by the seller which are identical to products earlier entered into the Reference Book shall be re-entered under a new reference stock number, since they constitute a new price classification.

(h) *Notification to customers.* Every person selling an imported textile product except at retail shall with each delivery supply the purchaser with a statement, which may be included in and made a part of the seller's invoice, specifying with respect to each price classification delivered (1) the seller's reference stock number, (2) a notation of the pricing provision employed, (3) the number of units sold, and (4) the price charged. This provision supersedes section 11 (b) (1) of Revised Maximum Price Regulation 183 with respect to sales of imported textile products.

(i) *Exceptions.* The provisions of this section 54 shall not apply to sales of textile products by religious or charitable institutions.

This amendment shall become effective November 22, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17758; Filed, November 3, 1943; 11:47 a. m.]

PART 1438—NONMETALLIC MINERALS

[MPR 327,[1] Amdt. 5]

CERTAIN NONMETALLIC MINERALS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 1438.2 (b) (7) is amended to read as follows:

(7) The provisions of Maximum Price Regulation No. 327 and of the General Maximum Price Regulation shall not apply to the sale or delivery of glass grade kyanite.

This amendment shall become effective November 8, 1943.

---

[2] 8 F.R. 3096, 3849, 4347, 4486, 4724, 4978, 4848, 6047, 6962, 8511, 9025, 9991, 11955, 13724.

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 2154, 4645, 6116, 11247.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17741; Filed, November 3, 1943; 11:45 a. m.]

PART 1499—COMMODITIES AND SERVICES

[Rev. SR 14 to GMPR, Amdt. 48]

REPORTS OF CARRIERS

The statement of the considerations involved in the issuance of this amendment has been issued simultaneously herewith and filed with the Division of the Federal Register.*

The first undesignated paragraph in section 7.6 (h) of Revised Supplementary Regulation No. 14 is amended to read as follows:

(h) *Reports.* Carriers whose maximum prices are subject to the provisions of this section 7.6 shall file the following information with the Office of Price Administration, Transportation and Public Utilities Division, Transportation Branch, Washington, D. C., within sixty days after the end of each quarter.

This amendment shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871, E.O. 9328, 8 F.R. 4681)

NOTE: Record keeping and reporting provisions of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17742; Filed, November 3, 1943; 11:44 a. m.]

PART 1499—COMMODITIES AND SERVICES

[SR 15 to GMPR, Amdt. 13]

CARRIER AND STORAGE SERVICES

A statement of the considerations involved in the issuance of this amendment has been issued simultaneously herewith and filed with the Division of the Federal Register.*

The first undesignated paragraph of § 1499.75 (a) (3) of Supplementary Regulation No. 15 to the General Maximum Price Regulation is amended to read as follows:

The Office of Price Administration, or any regional office thereof, may adjust the maximum prices established under the General Maximum Price Regulation for any person supplying service as a carrier, other than a common carrier, or for any person supplying storage or terminal service, who shows in an application for adjustment (i) that such maximum price subjects him to substantial hardship and (ii) that the adjustment requested is necessary to permit the continuance of the supply of an essential service for which there is no adequate substitute available at a price lower than the maximum price requested. A carrier who has applied, or is about to apply, for an adjustment under this § 1499.75 (a) (3) may agree to supply services from the date on which the application is filed with the Office of Price Administration at a price no higher than the maximum price for which he has applied. However, no payment above the existing maximum price may be made or received until a higher price has been authorized by an order of the Office of Price Administration containing no restriction against such payment. A carrier wishing to make any such agreement must advise the shipper that he has applied, or is about to apply, to the Office of Price Administration for a specified increase in his existing maximum price and that he may not receive any payment above his existing maximum price until a higher price has been authorized by the Office of Price Administration.

This amendment shall become effective November 8, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871, E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17744; Filed, November 3, 1943; 11:45 a. m.]

PART 1499—COMMODITIES AND SERVICES

[Order 624 Under 3 (b)]

STANDARD FURNITURE COMPANY

For the reasons set forth in an opinion issued simultaneously herewith, and filed with the Division of the Federal Register, it is hereby ordered:

§ 1499.2159 *Approval of maximum prices for maple and birch veneer for propeller blade manufacture sold by Standard Furniture Company.* (a) Standard Furniture Company, Herkimer, New York, may sell and deliver and any person may buy from this company maple and birch veneer of the following specifications for propeller blade manufacture at prices no higher than those hereinafter set forth:

1/10" maple veneer, sapwood only, sizes 17½" x 50½" and 10¾" x 54" as per St. Regis Paper Company's specifications M-22, as revised January 24, 1943—$63 per M square feet surface measure, f. o. b. mill.

1/16" birch veneer, sizes 17" x 27½", 24" x 27½", and 26" x 27½", as per "Parkwood" specifications,[1]—$39.30 per M square feet, surface measure, f. o. b. mill.

(b) All customary discounts and allowances in use by applicant during March 1942 shall apply to the prices authorized herein.

(c) All prayers of the applicant not granted herein are denied.

(d) This order may be revoked or amended by the Price Administrator at any time.

This order shall become effective November 3, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 2d day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17743; Filed, November 3, 1943; 11:43 a. m.]

TITLE 33—NAVIGATION AND NAVIGABLE WATERS

Chapter II—Corps of Engineers, War Department

PART 204—DANGER ZONE REGULATIONS

ATLANTIC OCEAN FIRING SECTORS BETWEEN BOGUE INLET AND CAPE FEAR, N. C.

Pursuant to the provisions of section 7 of the River and Harbor Act of August 8, 1917 (40 Stat. 266; 33 U. S. C. 1), the danger zones defined in § 204.55 (8 F.R. 12486), comprising firing ranges of the Anti-Aircraft Artillery Training Center, Camp Davis, North Carolina, and the Marine Base, New River, North Carolina, are hereby modified by the elimination of Sector No. 5 and the title is hereby amended to read as follows:

§ 204.55 *Waters of the Atlantic Ocean; Firing sectors between Bogue Inlet and Cape Fear, North Carolina*—(a) *The danger zones.* * * *

Sector No. 5. [Deleted]

(Sec. 7, 40 Stat. 266; 33 U.S.C. 1)

[Regs. 31 August 1943 as amended by Regs. 27 October 1943 (CE 800.2121 (Atlantic Ocean-North Carolina)—SPEKH)]

[SEAL] J. A. ULIO,
Major General,
The Adjutant General.

[F. R. Doc. 43-17732; Filed, November 3, 1943; 10:11 a. m.]

TITLE 49—TRANSPORTATION AND RAILROADS

Chapter I—Interstate Commerce Commission

[No. 3666]

PARTS 71 TO 80—TRANSPORTATION OF EXPLOSIVES

TANK CARS FOR SULPHURIC ACID

At a session of the Interstate Commerce Commission, Division 3, held at

*Copies may be obtained from the Office of Price Administration.

[1] Yellow and silver birch, thickness 1/16" or .0625. Tolerance allowed from .060 to .065. Tight cut; no knife marks. Dried to 5% moisture content before shipping. Sap, sap and heart, and heartwood accepted. Grain to run one in five. Black knots eliminated. Small, sound white knots no larger than ⅛" or 6 mm allowable. All such defects as splits, dirt, twisty growth, figures, bark growth, black streaks, stains, dry rot eliminated.

its office in Washington, D. C., on the 27th day of October, A. D. 1943.

In the matter of regulations for Transportation of Explosives and Other Dangerous Articles.

It appearing, that pursuant to section 233 of the Transportation of Explosives Act approved March 4, 1921, (41 Stat. 1445), and Part II of the Interstate Commerce Act, the Commission has formulated and published certain regulations for transportation of explosives and other dangerous articles;

It further appearing, that in applications 2750, 2989, and 2990 of the mechanical division, Association of American Railroads, we are asked to amend the aforesaid regulations as set forth in provisions made part hereof;

And it further appearing, that amendments involved in said applications, having been considered and found to be in accord with the best-known practicable means for securing safety in transit and with the need therefor for promoting safety of operation and standards of equipment used in the transportation of said dangerous articles:

It is ordered, That the aforesaid regulations for transportation of explosives and other dangerous articles be, and they are hereby, amended as follows:

Parts 1 to 4—Regulations for Transportation of Explosives and Other Dangerous Articles (CFR 71–80)

Decision of the Commission in this docket, dated August 6, 1941, granting authority to construct twenty-five (25) riveted tanks of tank cars, conforming to I. C. C. shipping container specification 103A, except toncan iron plates substituted for open-hearth boiler plate steel of flange quality, cars to be used in service tests in the transportation of sulfuric acid, is hereby amended so as to authorize fifty (50) additional tanks of tank cars conforming to the same specification as modified, to be constructed, reported, and used under the conditions set out in the said order of August 6, 1941.

It is further ordered, That this order amending the aforesaid regulations shall be effective on and after October 27, 1943, and shall remain in full force and effect and be observed until further order of the Commission;

And it is further ordered, That a copy of this order be served upon all the parties of record herein; and that notice of this order be given to the general public by depositing a copy in the office of the Secretary of the Commission at Washington, D. C., and by filing it with the Director, Division of the Federal Register.

(Sec. 233, 41 Stat. 1445, sec. 204, 49 Stat. 546, sec. 4, 52 Stat. 1232, sec. 20, 54 Stat. 922, 56 Stat. 176, 18 U.S.C. 383, 49 U.S.C. 304)

By the Commission, Division 3.

[SEAL] W. P. BARTEL, *Secretary.*

[F. R. Doc. 43-17737; Filed, November 3, 1943; 11:07 a. m.]

[SO 120-F]

PART 95—CAR SERVICE

EXCEPTED SHIPMENTS OF BITUMINOUS COAL

At a session of the Interstate Commerce Commission, Division 3, held at its office in Washington, D. C., on the 1st day of November, A. D. 1943.

Upon further consideration of the provisions of Service Order No. 120 (8 F.R. 5761) of April 30, 1943, and good cause appearing therefor:

It is ordered, That:

Section 95.11 *Bituminous coal* (Service Order No. 120 (8 F.R. 5761) of April 30, 1943) is hereby reinstated and made effective at 6 p. m., war time, November 1, 1943, until further order of the Commission, and it is hereby amended by deleting paragraph (b) from § 95.11 and amending paragraphs (c) (1) and (c) (2) to read as follows:

(1) Coal specifically consigned for all-rail shipments to Canadian destinations;

(2) Coal specifically consigned for water movement after dumping from cars, "other than coal moving to lower lakes dumping ports", but coal which has been loaded into cars after completion of the water movement shall be subject to this order;

And by adding the following exceptions to paragraph (c):

(7) Coal loaded in cars at the mine tipple on and after November 1, 1943, which mine has not suspended operations or which has resumed operations since November 1, 1943, provided that the billing covering such cars will carry a reference to this amendment (120-F) "mine in operation" as authority that such cars of coal are exempt from the provisions of this order.

(8) Coal specifically consigned for all-rail movement to a retail dealer;

(9) Unbilled coal now held at mines provided billing endorsed "No-bill Coal Authority Order 120-F"

And by amending Appendix A to Service Order No. 120 to read as shown on appendix attached hereto. (40 Stat. 101, sec. 402, 41 Stat. 476, sec. 4, 54 Stat. 901; 49 U.S.C. 1 (10)-(17).)

It is hereby further ordered, That copies of this order shall be served upon all common carriers by railroad subject to the Interstate Commerce Act, upon all State commissions, and upon the Association of American Railroads, Car Service Division, as agent of the railroads subscribing to the car service and per diem agreement under the terms of that agreement; and that notice of this order be given to the general public by depositing a copy in the office of the Secretary of the Commission at Washington, D. C., and by filing it with the Director, Division of the Federal Register.

By the Commission, Division 3.

[SEAL] W. P. BARTEL, *Secretary.*

APPENDIX A—UNDERTAKING TO BE FURNISHED IN DUPLICATE BY PERSON RECEIVING COAL

In order to establish the right of the undersigned to receive delivery of bituminous coal under the restrictions of War Production Board Order No. M-316, the undersigned certifies to _____ and to the War
(Name of RR)
Production Board that the undersigned has not, and will not have after receiving the coal identified below, more than a ten days' supply thereof as defined in said Order, and that unless it obtains such coal it will suffer extensive and irreparable damage from a shut down of its plant. The undersigned (if not the original consignee of the coal) agrees, in consideration of receipt of such coal, to pay all obligations of the consignee to the consignor with respect to such coal and to pay to said railroad all applicable transportation charges, demurrage charges and other accessorial charges.

_____
(date)

_____
(Name of person receiving coal)

By _____
(Signature of authorized official)

Identification of bituminous coal covered by this undertaking:

[F. R. Doc. 43-17736; Filed, November 3, 1943; 11:07 a. m.]

Notices

DEPARTMENT OF THE INTERIOR.

Coal Mines Administration.

[Order T-115]

ORDER TERMINATING APPOINTMENTS OF ALL REMAINING OPERATING MANAGERS

NOVEMBER 1, 1943.

Orders have been issued terminating the possession of all coal mines taken by the Government under the provisions of Executive Order No. 9340 (8 F.R. 5695). Certain mining companies have duly executed and delivered to the Administrator either an Instrument of Agreement and Certification, or Instrument No. 1 or Instrument No. 2, as provided for in the Regulations for the Operation of the Coal Mines Under Government Control, as amended (8 F.R. 6655, 10712, 11344). The appointments of the operating managers for the United States for the mines of certain of those companies have already been terminated. Those appointments of the operating managers for the United States for the mines of the companies which have filed such an Instrument, which appointments have not yet been terminated, should now be terminated; and provision should be made for the automatic termination of the appointments of operating managers for the United States for the mines of those companies which may hereafter file such an Instrument.

Accordingly, I hereby order and direct that all the appointments of the operating managers for the United States for the coal mines of those mining companies which have already duly executed and delivered to the Administrator an Instrument of Agreement and Certification, Instrument No. 1 or Instrument No. 2, as provided for in the Regulations for the Operation of Coal Mines Under Government Control, as amended (8 F.R. 6655, 10712, 11344, and

which appointments have not yet been terminated, be and they hereby are terminated.

I further order and direct that the appointments of the operating managers for the United States for the coal mines of the mining companies which hereafter duly execute and deliver to the Administrator such an Instrument as provided in the aforesaid regulations, shall be and they are hereby terminated, for the period of Government possession and control extending from May 1 through October 12, 1943, or any portion thereof, the termination to become effective as of the date of the delivery of such an Instrument to the Administrator.

HAROLD L. ICKES,
Secretary of the Interior.

[F. R. Doc. 43-17731; Filed, November 3, 1943; 10:03 a. m.]

[Order 1888]

ANTHRACITE AND BITUMINOUS COAL MINES

ORDER TAKING POSSESSION

NOVEMBER 1, 1943.

By virtue of the authority vested in me by the President of the United States by Executive Order dated November 1, 1943,[1] and having determined that a strike or stoppage has occurred or is threatened at each and all of the coal mines operated by the mining companies listed in Appendix A,[2] attached hereto and made a part hereof, I do hereby, effective forthwith, take possession of each and all of such coal mines, including any and all real and personal property, franchises, rights, facilities, funds and other assets used in connection with the operation of such mines.

The Regulations for the Operation of Coal Mines Under Government Control, as amended (8 F.R. 6655, 10712, 11344), heretofore issued by me, together with such further regulations as may from time to time be issued, shall in all respects be applicable to the mines possession of which is taken by the Government.

The President of each of the mining companies listed in Appendix A [2] heretofore referred to (or if there is no president, its chief executive officer) is hereby, and until further notice, designated operating manager for the United States for each and all of the mines of the company. Unless advice to the contrary is received within ten days, the aforesaid President (or chief executive officer) shall be deemed to have accepted such designation. As operating manager for the United States, he is authorized and directed to operate any and all such mines in accordance with the aforementioned Regulations for the Operation of Coal Mines Under Government Control, and such further regulations as may from time to time be issued, and to do all things necessary and appropriate for the operation of such mines and for the production, distribution and sale of their products.

The operating manager for the United States shall forthwith fly the flag of the United States at each of the mining properties of his company and shall conspicuously display at each of such properties copies of a poster to be supplied by the Department of the Interior and reading

NOTICE

In accordance with the proclamation of the President of the United States, Government possession of the coal mines of this mining company has been taken by Order of the Secretary of the Interior.

HAROLD L. ICKES,
Secretary of the Interior.

[F. R. Doc. 43-17730; Filed, November 3, 1943; 10:03 a. m.]

[1] E.O. 9393, 8 F.R. 14877.

[2] Filed as part of the original document.

DEPARTMENT OF AGRICULTURE.

Rural Electrification Administration.

[A. O. 782]

ALLOCATION OF FUNDS FOR LOANS

AMENDMENTS OF PRIOR ORDERS

OCTOBER 20, 1943.

I hereby amend: (a) Administrative Order No. 675, dated February 19, 1942, by rescinding the allocation of $12,000 therein made to "Florida 2022S2 Escambia";

(b) Administrative Order No. 610, dated July 25, 1941, by rescinding the allocation of $3,000 therein made to "Kansas 2008W2 Allen";

(c) Administrative Order No. 548, dated December 19, 1940, by reducing the allocation of $23,000 therein made to "Maine 1002C1 Penobscot" by $13,000, so that the reduced allocation shall be $10,000;

(d) Administrative Order No. 681, dated March 2, 1942, by rescinding the allocation of $3,000 therein made to "Montana 2017C1 Rosebud";

(e) Administrative Order No. 220, dated March 21, 1938, by reducing the allocation of $250,000 therein made to "New York 8018A1 Tompkins" (designation changed to read "New York 8018A1 N. Y. S. E. & G." by Administrative Order No. 469, dated June 4, 1940) by $7,099.83, so that the reduced allocation shall be $242,900.17;

(f) Administrative Order No. 298, dated October 8, 1938, by reducing the allocation of $500,000 therein made to "New York R9018B1 Tompkins" (designation changed to read "New York R9018B1 N. Y. S. E. & G." by Administrative Order No. 469, dated June 4, 1940) by $55,423.78, so that the reduced allocation shall be $444,576.22;

(g) Administrative Order No. 319, dated January 31, 1939, by reducing the allocation of $300,000 therein made to "New York 9018C1 N. Y. S. E. & G." (designation changed to read "New York R9018C1 N. Y. S. E. & G." by Administrative Order No. 324, dated March 11, 1939) by $17,852.92, so that the reduced allocation shall be $282,147.08;

(h) Administrative Order No. 346, dated May 18, 1939, by reducing the allocation of $325,000 therein made to "New York R9018C2 N. Y. S. E. & G." by $47,589.12, so that the reduced allocation shall be $277,410.88;

(i) Administrative Order No. 424, dated January 5, 1940, by reducing the allocation of $370,000 therein made to "New York 0018D1 N.Y.S.E.&G." by $16,287.69, so that the reduced allocation shall be $353,712.31;

(j) Administrative Order No. 676, dated February 20, 1942, by rescinding the allocation of $15,000 therein made to "Oklahoma 2021S2 Washita";

(k) Administrative Order No. 620, dated September 23, 1941, by rescinding the allocation of $8,000 therein made to "South Dakota 2017S1 Hamlin";

(l) Administrative Order No. 636, dated November 10, 1941, by rescinding the allocation of $230,000 therein made to "Tennessee 2036A1 Scott";

(m) Administrative Order No. 636, dated November 10, 1941, by rescinding the allocation of $127,000 therein made to "Wyoming 2012C1 Park";

(n) Administrative Order No. 676, dated February 20, 1942, by rescinding the allocation of $10,00 therein made to "Wyoming 2016S1 Hot Springs."

HARRY SLATTERY,
Administrator.

[F. R. Doc. 43-17734; Filed, November 3, 1943; 11:23 a. m.]

FEDERAL COMMUNICATIONS COMMISSION.

[Docket No. 6552]

PACIFIC AGRICULTURAL FOUNDATION, LTD.

NOTICE OF HEARING

In re application of Pacific Agricultural Foundation, Ltd. (KQW); Date filed, August 20, 1943; for modification of license; class of service, broadcast; class of station, broadcast; Location, San Jose, California. Operating assignment specified, frequency, 750 kc; power, 5 kw; hours of operation, unlimited (DA—night and day). File No. B5-ML-1172.

You are hereby notified that the Commission has examined the above-described application and has designated the matter for hearing for the following reasons:

1. To determine whether the granting of the application would be consistent with § 3.30 (b) of the rules and regulations of the Federal Communications Commission.

2. To determine whether Station KQW, operating as proposed, would provide a minimum field intensity of 25 to 50 mv/m over the business and factory areas, and 5 to 10 mv/m over the residential districts of San Francisco, California, as contemplated by the Standards

of Good Engineering Practice of the Federal Communications Commission.

3. To determine the purposes to be served by the proposed move of main studio of Station KQW and the effect thereof upon the operations of the station, the service rendered by it, those making use of its facilities and the public.

4. To determine whether granting of the application would tend toward a fair, efficient and equitable distribution of radio service to the communities concerned.

5. To determine whether, in view of the facts relating to the above issues, and in view of the fact that Station KJBS, San Francisco, and the applicant are under common control, public interest, convenience and necessity would be served by granting the application.

The application involved herein will not be granted by the Commission unless the issues listed above are determined in favor of the applicant on the basis of a record duly and properly made by means of a formal hearing.

The applicant is hereby given the opportunity to obtain a hearing on such issues by filing a written appearance in accordance with the provisions of § 1.382 (b) of the Commission's rules of practice and procedure. Persons other than the applicant who desire to be heard must file a petition to intervene in accordance with the provisions of § 1.102 of the Commission's rules of practice and procedure.

The applicant's address is as follows: Pacific Agricultural Foundation, Ltd., Radio Station KQW, 87 East San Antonio Street, San Jose 14, California.

Dated at Washington, D. C., November 1, 1943.

By the Commission.

[SEAL] T. J. SLOWIE,
Secretary.

[F. R. Doc. 43-17735; Filed, November 3, 1943; 11:31 a. m.]

OFFICE OF PRICE ADMINISTRATION.

Regional and District Office Orders.

LIST OF COMMUNITY CEILING PRICE ORDERS

The following orders under General Order 51 were filed with the Division of the Federal Register on November 2, 1943.

REGION I

Maine, Order No. 7, Amendment No. 2; filed 10:32 a. m.

Maine, Order No. 8, Amendment No. 2; filed 10:33 a. m.

Maine, Order No. 9, Amendment No. 2; filed 10:32 a. m.

Maine, Order No. 10, Amendment No. 1; filed 10:33 a. m.

REGION II

District of Columbia, Order No. 6, Correction; filed 10:23 a. m.

New York, Order No. 7, Correction; filed 10:23 a. m.

REGION III

Cincinnati, Order No. 1-F; filed 10:24 a. m.
Cleveland, Order No. F-2; filed 10:26 a. m.
Iron Mountain, Order 1-F; filed 10:21 a. m.
Lexington, Order No. 1-F; filed 10:23 a. m.

REGION IV

Jackson, Order No. 6, Amendment No. 6; filed 10:27 a. m.

Memphis, Order No. 4-F, Amendment No. 3; filed 10:28 a. m.

Memphis, Order No. 10; filed 10:21 a. m.

Raleigh, Order No. 9, Amendment No. 3; filed 10:25 a. m.

REGION V

San Antonio, Order No. 5, Amendment No. 1; filed 10:27 a. m.

San Antonio, Order No. 6, Amendment No. 1; filed 10:27 a. m.

REGION VI

Bismarck, Order No. 4, Amendment No. 2; filed 10:32 a. m.

Bismarck, Order No. 5, Amendment No. 1; filed 10:31 a. m.

Bismarck, Order No. 6, Amendment No. 1; filed 10:31 a. m.

Bismarck, Order No. 9, Amendment No. 1; filed 10:31 a. m.

Bismarck, Order No. 10, Amendment No. 1; filed 10:31 a. m.

Fargo-Moorhead, Order No. 9, Amendment No. 2; filed 10:30 a. m.

Fargo-Moorhead, Order No. 10, Amendment No. 1; filed 10:30 a. m.

Fargo-Moorhead, Order No. 11, Amendment No. 1; filed 10:29 a. m.

Fargo-Moorhead, Order No. 12, Amendment No. 2; filed 10:29 a. m.

Fargo-Moorhead, Order No. 13, Amendment No. 1; filed 10:29 a. m.

Fargo-Moorhead, Order No. 14, Amendment No. 1; filed 10:29 a. m.

Moline, Order No. 10, Amendment No. 1; filed 10:21 a. m.

Moline, Order No. 15; filed 10:34 a. m.

REGION VIII

San Diego, Order No. 1-F, Amendment No. 8; filed 10:24 a. m.

San Diego, Order No. 4, Amendment No. 7; filed 10:25 a. m.

Seattle, Order No. 22; filed 10:33 a. m.

Copies of these orders may be obtained from the issuing offices.

ERVIN H. POLLACK,
Head, Editorial and Reference Section.

[F. R. Doc. 43-17759; Filed, November 3, 1943; 11:47 a. m.]

WAR FOOD ADMINISTRATION.

PUERTO RICO AND VIRGIN ISLANDS

NOTICE OF HEARINGS ON SUGARCANE PRICES AND WAGE RATES

Pursuant to the authority contained in subsections (b) and (d) of section 301 and section 511 of the Sugar Act of 1937 (Public, No. 414, 75th Congress), as amended, and Executive Order No. 9322, issued March 26, 1943, as amended by Executive Order No. 9334, issued April 19, 1943, notice is hereby given that public hearings will be held at San Juan, Puerto Rico, in the Auditorium of the Ateneo on November 12, 1943 at 9:30 a. m. and at Christiansted, St. Croix, Virgin Islands, in the Municipal Council Hall, on November 16, 1943 at 9:30 a. m.

The purpose of such hearings is to receive evidence likely to be of assistance to the War Food Administrator in determining (1), pursuant to the provisions of subsection (b) of section 301 of the said act, fair and reasonable wage rates to be paid in Puerto Rico and in the Virgin Islands to persons employed in connection with the production, cultivation or harvesting of the 1943-44 crop on farms with respect to which applications for payment under the act are made, and (2), pursuant to the provisions of subsection (d) of section 301 of the said act, fair and reasonable prices for the 1943-44 crop of sugarcane to be paid, under either purchase or toll agreements, by persons who, as producers, apply for payments under the said act; and (3), pursuant to the provisions of section 511 of the said act, to receive evidence likely to be of assistance to the War Food Administrator in making recommendations with respect to the terms and conditions of contracts between producers and processors of sugarcane.

Such hearings, after being called to order at the time and place mentioned above, may for convenience, be adjourned to such other place in the same city as the presiding officers may designate and may be continued from day to day within the discretion of the presiding officers.

Joshua Bernhardt, C. M. Nicholson, H. H. Simpson, G. Laguardia, J. Capo Caballero and A. G. Panossian are hereby designated as presiding officers to conduct, either jointly or severally, the foregoing hearings.

Done at Washington, D. C., this 3d day of November 1943.

WILSON COWEN,
Assistant War Food Administrator.

[F. R. Doc. 43-17733; Filed, November 3, 1943; 11:22 a. m.]